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No. _____

In The

Supreme Court of the United States

CITY OF LOS ANGELES, *et al.*,

Petitioners,

v.

UNITED STATES DEPARTMENT OF TRANSPORTATION, *et al.*,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether interpreting federal airport grant conditions to impose a previously unstated condition requiring governmental airport proprietors to use historic cost, rather than fair market value, in valuing airfield land violates the requirement of *Pennhurst State School & Hospital v. Halderman*, 451 U.S. 1 (1981), that Congress must impose conditions on the grant of federal monies clearly and unambiguously.

2. Whether the proper standard of judicial review of an agency's interpretation of a grant condition is one derived from *Pennhurst*, under which the grant recipient must have received clear and unambiguous notice of the grant condition as interpreted by the agency, or one derived from *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), under which any reasonable agency interpretation is entitled to deference, thus resolving a conflict in the circuits.

3. Whether consideration of non-airfield revenues and municipal benefits generated by the airport in determining the reasonableness of airfield charges violates *Northwest Airlines, Inc. v. County of Kent, Michigan*, 510 U.S. 355 (1994) and 49 U.S.C. § 47129, both of which permit airports to use a compensatory rate methodology to set airfield charges on the basis of airfield costs.

PARTIES TO THE PROCEEDING

The petitioners are the City of Los Angeles, the City of Los Angeles Department of Airports and the Los Angeles Board of Airport Commissioners. The Airports Council International-North America intervened in support of petitioners both before the U.S. Department of Transportation and the court of appeals.

The respondents are the United States Department of Transportation, Rodney E. Slater, Secretary of Transportation, and Patrick V. Murphy, Deputy Assistant Secretary for Aviation and International Affairs. The Air Transport Association of America intervened in support of respondents both before the U.S. Department of Transportation and the court of appeals.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners City of Los Angeles, City of Los Angeles Department of Airports, and Los Angeles Board of Airport Commissioners (collectively, the "City") respectfully request that a writ of certiorari issue to review the decision of the United States Court of Appeals for the District of Columbia Circuit entered in this case on February 5, 1999.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the District of Columbia Circuit dated February 5, 1999, which denied the City's petition for review of the Final Order on remand issued by the United States Department of Transportation ("DOT"), is reported at *City of Los Angeles v. DOT*, 165 F.3d 972 (D.C. Cir.) ("*LAX II*"), *reh'g denied en banc*, 179 F.3d 937 (D.C. Cir. 1999), and is reprinted in the Appendix ("App.") at 1a. The court of appeals' denial of the City's petition for rehearing *en banc* of the opinion issued in *LAX II*, the concurring statement of Judge Silberman, and the dissenting statement of Judges Williams and Ginsburg issued on June 18, 1999, are reported at *City of Los Angeles v. DOT*, 179 F.3d 937 (D.C. Cir. 1999), and are reprinted at App. 109a.

DOT's Final Order on remand, *Los Angeles International Airport Rates Proceeding and Second Los Angeles International Airport Rates Proceeding (Remand Decision)*, Order No. 97-12-31 (Dec. 23, 1997) ("*Remand Decision*"), is unreported, but can be found at 1997 DOT Av. LEXIS 673, and is reprinted at App. 18a.

The opinion of the United States Court of Appeals for the District of Columbia Circuit, dated January 17, 1997, which affirmed in part and remanded in part DOT's Final

Order issued in the *Los Angeles International Airport Rates Proceeding*, is reported at *Los Angeles Department of Airports v. DOT*, 103 F.3d 1027 (D.C. Cir. 1997) ("*LAX I*"), and is reprinted at App. 79a.

The opinion of the United States Court of Appeals for the District of Columbia Circuit, dated August 1, 1997, which vacated portions of DOT's Final Policy Regarding Airport Rates and Charges, 61 Fed. Reg. 31944 (June 21, 1996) ("Final Policy"), is reported at *Air Transport Association of America v. DOT*, 119 F.3d 38 (D.C. Cir.), *as amended by* 129 F.3d 625 (D.C. Cir. 1997) ("*Policy Appeal*"). Though not an opinion in this case, the opinion below identifies the *Policy Appeal* as a "related proceeding," App. 8a, and thus the *Policy Appeal* is reprinted at App. 119a.[1]

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[1] To place these various opinions in context, in 1995, complainant airlines filed an administrative complaint against the City concerning landing fees imposed at Los Angeles International Airport ("LAX") in 1993. Following an administrative trial, DOT issued its Final Order in the *Los Angeles International Rates Proceeding*, Order No. 95-6-26 (June 30, 1995) ("*LAX I(DOT)*"). This opinion is unreported, but can be found at 1995 DOT Av. LEXIS 391. The complainant airlines and the City both petitioned the United States Court of Appeals for the District of Columbia Circuit for review of *LAX I(DOT)*.

Shortly after DOT issued *LAX I(DOT)*, complainant airlines filed a second administrative complaint against the City concerning landing fees imposed at LAX in 1995. Again following an administrative trial, DOT issued its Final Order in the *Second Los Angeles International Rates Proceeding*, Order No. 95-12-33 (Dec. 23, 1995) ("*LAX II(DOT)*"). This opinion is unreported, but can be found at 1995 DOT Av. LEXIS 841. The complainant airlines and the City both petitioned the D.C. Circuit for review of *LAX II(DOT)*.

On January 17, 1997, the court of appeals issued *LAX I*, in which it affirmed *LAX I(DOT)* in part and remanded other parts of the case to DOT for reconsideration. On March 17, 1997, the

JURISDICTION

The judgment of the court of appeals was entered on February 5, 1999. App. 1a. The City and intervenor Airports Council International-North America ("ACI-NA") filed timely petitions for rehearing and suggestions for rehearing *en banc* on March 22, 1999. The court of appeals denied those petitions on June 18, 1999. App. 109a; App. 118a. The jurisdiction of the court of appeals was based on 49 U.S.C. § 47129(c)(5), 49 U.S.C. § 46110(a) and 5 U.S.C. §§ 701-06. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

PERTINENT STATUTORY PROVISIONS

49 U.S.C. § 40116(e)
49 U.S.C. § 47107(a), (c)
49 U.S.C. § 47129
49 U.S.C. app. § 1513(b) (1988 & Supp. 1993)
49 U.S.C. app. § 2210(a) (1988 & Supp. 1993)
These provisions are printed in Appendix B.

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court of appeals remanded *LAX II(DOT)* to DOT for reconsideration with the remanded issues in *LAX I. Air Transp. Ass'n of Am. v. DOT*, No. 96-1018, *et al.* (D.C. Cir.). After the court of appeals issued its decision in *LAX I*, a different panel of the court issued its decision in the *Policy Appeal*, which vacated certain provisions of DOT's Final Policy. Subsequent to the *Policy Appeal* decision, DOT issued its *Remand Decision*, addressing the issues in both *LAX I(DOT)* and *LAX II(DOT)* that had been remanded to it by the court of appeals. Because the substance of *LAX I(DOT)* and *LAX II(DOT)* has either been superseded by or incorporated into the *Remand Decision*, they are not reprinted in the Appendix. In response to the City's petition for review of the *Remand Decision*, the court of appeals issued *LAX II*, the decision below, for which rehearing was denied *en banc*.

STATEMENT OF THE CASE

For many years, the federal government has provided financial assistance to airport sponsors through grant programs to aid in the development of the Nation's aviation system. *See, e.g.*, Airport and Airway Development Act of 1970, Pub. L. No. 91-258, 84 Stat. 219 *et seq.* (formerly codified at 49 U.S.C. app. § 1701 *et seq.*); Airport and Airway Improvement Act of 1982, Pub. L. No. 97-248, 96 Stat. 671, 49 U.S.C. § 47101 *et seq.* (formerly codified at 49 U.S.C. app. § 2210 *et seq.*) ("AAIA"). *See also DOT v. Paralyzed Veterans of Am.*, 477 U.S. 597, 604-05 (1986) (summarizing airport aid programs).

Between the enactment of the AAIA in 1982 and 1994, the City accepted a number of Airport Improvement Program ("AIP") grants, executing a separate grant agreement with the federal government for each one, and agreeing in exchange for the money to abide by the express terms and conditions contained in the grant agreements. The grant conditions are set forth in and required by the AAIA and impose certain obligations and restrictions on the City. *See* 49 U.S.C. app. § 2210(a) (App. 155a-163a).[2] But they do not address the specific issue raised in the underlying litigation: whether it is reasonable for the City, in charging landing fees at Los Angeles International Airport ("LAX"), to include a rental charge for use of LAX's airfield land based on the land's fair market value ("FMV"). Indeed, the grant conditions set

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[2] The AAIA was recodified and amended in 1994. The statutory references in this petition are to the AAIA prior to that recodification, because it is the language of the statute before it was recodified which is applicable to the grants at issue in this case.

forth in the AAIA do not address in any specific manner the methodology to be used by airport sponsors in setting airport fees (also known as "rates and charges").[3]

In the three administrative decisions DOT issued below – *LAX I(DOT)*, *LAX II(DOT)*, and the *Remand Decision* – DOT clung to the conclusion that the City's FMV airfield land charge was inherently unreasonable, articulating different rationales in response to the court of appeals' decisions in *LAX I* and the *Policy Appeal*. DOT's latest rationale, appearing in its *Remand Decision*, is that two of the grant conditions prescribed by the AAIA bar the City from using FMV and require the City to use historic cost to value its airfield land for rate purposes. DOT reached its conclusion despite the fact that one of those assurances merely requires the City to make LAX "available for public use on fair and reasonable terms," 49 U.S.C. app. § 2210(a)(1) (App. 155a), and the other only permits the City to make alterations to LAX's layout plan if DOT decides that the change will not "adversely affect the safety, utility, or efficiency of the airport," 49 U.S.C. app. § 2210(a)(15)(C) (App. 161a). DOT reasoned that these generally-worded grant conditions eliminate any opportunity the City has to change the use of LAX, and therefore the City has no opportunity costs associated with dedicating airfield land for airline use at LAX. DOT concluded, as a result, that it was unreasonable for

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[3] There is only one grant condition that even generally addresses rate methodology; it requires that airports must "maintain a fee and rental structure for the facilities and services being provided the airport users which will make the airport as self-sustaining as possible . . . . " 49 U.S.C. app. § 2210(a)(9) (App. 158a) (recodified at 49 U.S.C. § 47107(a)(13)(A) (App. 143a)).

the City to charge a FMV-based rent for use of LAX's airfield land.

In the opinion below, the court of appeals upheld the *Remand Decision* by giving undue deference to DOT's conclusion that the grant conditions informed the City that it was unreasonable to charge a FMV-based rent, even though the court below recognized that "some or many economists would disapprove of the Department's approach" of requiring the use of historic cost and that "an economist . . . might well take the City's view" that charging a FMV rent was reasonable. App. 10a. In deferring to DOT, the court of appeals rejected the argument that DOT's decision imposed a new grant condition, contrary to this Court's holding in *Pennhurst State School & Hospital v. Halderman*, 451 U.S. 1 (1981). The approach of the court of appeals to the *Pennhurst* issue is in direct conflict with the approach taken recently by the United States Court of Appeals for the Fourth Circuit in its *en banc* opinion in *Virginia Department of Education v. Riley*, 106 F.3d 559 (4th Cir. 1997) (*per curiam*, adopting the dissenting panel opinion of Luttig, J.), and by the United States Court of Appeals for the Seventh Circuit in *Doe v. Oak Park & River Forest High School District*, 115 F.3d 1273 (7th Cir. 1997).

The court of appeals also rejected the City's argument that DOT's other rationale for rejecting the use of FMV – that any opportunity costs of the City were "covered" by the overall benefits enjoyed by the City as a result of operating LAX – was inconsistent with this Court's decision in *Northwest Airlines, Inc. v. County of Kent, Michigan*, 510 U.S. 355 (1994) ("*Kent County*"), and the provisions of 49 U.S.C. § 47129, which affirm the right of airport sponsors to set compensatory rates.

The financial impact on the City of the court of appeals' decision is substantial. A fee calculated using the FMV of the airfield land results in additional annual income to LAX of nearly $15 million per year. By contrast, because virtually all of the airfield land was acquired decades ago for prices that are miniscule compared to the FMV of that land in 1992, DOT proposed essentially to preclude the City from assessing *any* airfield land rental charge. Consequently, the court of appeals' decision, if not overturned, will result in the City refunding to the commercial airlines who use LAX more than $90 million in fees plus interest for the period beginning when the disputed landing fees were first imposed in July 1993.

The broader implications of the court of appeals' decision for state and local governments that have agreed to conditions set forth in grant agreements are also far reaching. Under the court of appeals' decision, administrative agencies would be permitted to treat governmental grant recipients in the same manner as they treat private regulated entities: free to impose any restriction or obligation so long as they are judged reasonable under the *Chevron* standard,[4] without regard to whether the restriction or obligation was unambiguously set forth in grant conditions as required by *Pennhurst*. Such a result would grossly distort the accepted relationship between sovereigns inherent in "Our Federalism," *Younger v. Harris*, 401 U.S. 37, 44 (1971), by greatly expanding the scope of the federal government's power to regulate state and local governments pursuant to Congress's Spending Clause power.

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[4] *See Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984).

A. The City Adopts Landing Fees At LAX Based On A Compensatory Methodology

As of July 1, 1993, the City began using a compensatory method to set the landing fees it charges airlines for their use of LAX's airfield facilities and related services (the "1993 Fees"). Under the compensatory method, airlines are required to pay through landing fees the full cost of the airfield facilities and services they use, allocated on the basis of the weight of each aircraft that lands at LAX.[5] The compensatory system adopted by the City for use at LAX includes a charge for the use of 1780.3 acres of land (nearly three square miles) on which the airport's runways, taxiways and aprons are located ("airfield land"). Under LAX's compensatory system, the rental cost of the airfield land is based on the land's FMV in early 1992, which was undisputed. App. 91a-92a.[6] The 1993 Fees were replaced by new fees, based on the same compensatory methodology, which became effective as of July 1, 1995 (the "1995 Fees"). The 1993 Fees and 1995 Fees contained identical charges for the airlines' use of LAX's airfield land.[7]

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[5] Previously, landing fees at LAX had been set by agreement with the airlines using a residual methodology under which the fees were subsidized by non-aeronautical revenues and thus did not reflect the actual cost of aeronautical services and facilities provided to the airlines. *E.g.*, App. 81a-82a.

[6] Although to the City's knowledge FMV had not previously been used to value airfield land, it is undisputed that for decades airports have been using FMV to value land underlying other airport facilities, *e.g.*, terminals, cargo buildings, and maintenance facilities.

[7] The 1995 Fees have been supplanted by new fees which continue to include a FMV charge for airfield land. Subject to a

B. The Established Law Regarding The Reasonableness Of Airport Fees

When adopted, the 1993 Fees and the 1995 Fees were fully consistent with the terms of the two statutes which then – and now – address airport charges to airlines. The Anti-Head Tax Act ("AHTA"), enacted in 1973, prohibits the imposition of "head taxes" on air passengers. It specifically permits airports, however, to collect "*reasonable* rental charges, landing fees, and other service charges from aircraft operators for the use of airport facilities." 49 U.S.C. app. § 1513(b) (App. 154a) (emphasis added) (recodified at 49 U.S.C. § 40116(e)(2) (App. 140a)). The AAIA, enacted in 1982, contains the previously quoted conditions requiring an airport receiving grants to "be available for public use on fair and reasonable terms," and requiring DOT's approval before altering the airport layout plan. 49 U.S.C. app. § 2210(a)(1), (15)(C) (App. 155a, 161a).[8]

This Court has once before construed the reasonableness standard imposed by the AHTA. In 1994 (at about the time the City took its last airport grant at LAX), in response to an airline challenge, this Court in *Kent County* upheld an airport sponsor's use of a compensatory methodology and rejected the claim that airport owners must reduce airline charges below cost whenever there is surplus non-aeronautical revenue at an airport. 510 U.S. at

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duty to refund the FMV charge if it is ultimately disallowed, the new fees have not been the subject of separate litigation.

[8] In the recodification of Title 49 in 1994, after the City took its last airport grant at LAX, the quoted grant condition was changed to provide that an airport receiving grants "be available for public use on reasonable conditions." 49 U.S.C. § 47107(a)(1) (App. 141a).

369-74. In *Kent County* this Court held that, in the absence of regulations adopted by DOT, a standard derived from the dormant Commerce Clause jurisprudence would be applicable to determining whether an airport charge is reasonable and identified three factors to be considered: whether the fees (1) were based on a fair approximation of the use of the facilities, (2) were not excessive in relation to the benefits conferred, and (3) do not discriminate against interstate commerce. *Id.* at 369 (*citing Evansville-Vanderburgh Airport Auth. Dist. v. Delta Airlines, Inc.*, 405 U.S. 707, 716-17 (1972)).

C. The Federal Aviation Administration Authorization Act Of 1994

The Federal Aviation Administration Authorization Act of 1994 ("FAAAA") was enacted on August 23, 1994. In addition to directing DOT to establish guidelines for determining whether an airport fee is reasonable (accepting this Court's invitation made in *Kent County*, 510 U.S. at 368 n.14), the FAAAA created an expedited procedure for resolution of airport-airline disputes regarding fees charged to airlines for their use of airport facilities and services.[9] 49 U.S.C. §§ 47129(b), (c) (App. 150a-151a).

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[9] On February 3, 1995, DOT published an interim Policy Regarding Airport Rates and Charges ("Interim Policy"), which was superseded by the Final Policy issued on June 21, 1996. Significant portions of the Final Policy – including DOT's requirement that airports use historic costs to value airfield assets (including land) – were vacated in the *Policy Appeal*. *See* App. 135a (DOT "simply has not explained why fair market valuation may be appropriate for other portions of the airport, but too difficult to use in valuing airfield assets.").

The FAAAA expressly affirms that airport owners, such as the City, can use a compensatory rate methodology to set fees charged to airlines for use of airfield facilities at airports. *Id.* § 47129(a)(2) (App. 149a). Section 47129 neither requires nor prohibits any particular method for valuing land anywhere on an airport and specifically bars DOT from setting the level of fees charged. *Id.* § 47129(a)(3) (App. 149a). As DOT itself has repeatedly emphasized, the FAAAA did not "change the substantive rights and duties of the airports or the airlines." *See, e.g.*, App. 23a.

D. The Relevant Procedural History Of The Litigation Below

1. The underlying petitions for review arose from two of the first proceedings brought under 49 U.S.C. § 47129.[10] The complainant airlines in the *Los Angeles International Airport Rates Proceeding* and in the *Second Los Angeles International Airport Rates Proceeding* (the "Airlines") sought determinations by DOT that the 1993 Fees and the 1995 Fees, respectively, violated the statutory "reasonableness" requirement imposed by the AAIA and the AHTA. The Airlines claimed that the City's use of

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[10] Various complaints have been filed with the Secretary challenging airport fees pursuant to the provisions of 49 U.S.C. § 47129(a)(1)(B). Although the statute provides that petitions for review of DOT's Final Order may be reviewed either "in the Circuit Court of Appeals for the District of Columbia Circuit or the court of appeals in the circuit where the airport which gives rise to the written complaint is located," 49 U.S.C. § 47129(c)(5) (App. 151a), every petitioner seeking review of a DOT final order in a Section 47129 proceeding thus far has filed its petition in the D.C. Circuit.

FMV to measure the cost of the land in the airfield rate base is illegal *per se* and that the AAIA and AHTA mandate use of historic costs. In each proceeding, DOT agreed, and the City petitioned the court of appeals for review of each final order issued by DOT.

2. The court of appeals in *LAX I* granted the City's petition. It held that DOT's view of reasonableness represented a "fundamental misunderstanding of the governing law," App. 90a, and that the "Secretary's view of historic cost as the apodictically indicated measure of 'actual cost' [was] not . . . supported by the applicable law," App. 89a. The court of appeals further held that the AHTA neither prohibited the City from including in its landing fee a FMV airfield rental charge nor required the use of historic cost. App. 90a.

In reaching these conclusions, the court of appeals observed that this Court has never "held that historic cost represents the only true measure of cost and the Secretary points to no law, regulation, or agency decision to that effect." App. 89a. In rejecting DOT's position that opportunity cost is not an actual cost, the court of appeals found that nothing in existing, applicable law prescribed "an accounting rather than an economic conception of cost in airport ratemaking." App. 90a.[11]

3. On remand, DOT nevertheless concluded again that "the fair market value charge for the airfield land is unreasonable." App. 29a. This time DOT justified its decision by asserting that the City incurs no opportunity

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[11] The court of appeals separately remanded the petitions for review of *LAX II(DOT)* to DOT for reconsideration along with *LAX I(DOT)*. DOT's *Remand Decision* thus applied to both the 1993 Fees and the 1995 Fees. *See supra* note 1.

costs because the City "has no opportunity to use its LAX property for a non-airport use." App 29a; *see also* App. 38a-44a. DOT also found that the City "needs no additional incentives to operate LAX as an airport, since the Los Angeles area obtains substantial economic benefits from the airport's operation," and that even if the City did have opportunity costs, they were "covered" by these "benefits." App. 29a; *see also* App. 45a-52a. Finally, DOT concluded that requiring the City to use historic cost was consistent with the Fifth Amendment's Takings Clause, and summarily refused to grant the City a hearing to determine the constitutionally-mandated fair rate of return. App. 68a-77a.

4. The City again petitioned the court of appeals for review, arguing that the *Remand Decision* was inconsistent with the court of appeals' decision in *LAX I* and with this Court's decisions in *Pennhurst* and *Kent County*. Specifically, the City argued that, contrary to DOT's decision, the two grant conditions cited by DOT – one which requires the City to keep LAX "available for public use on fair and reasonable terms" and the other which permits the City to make alterations to LAX's layout plan only if DOT decides that the change will not "adversely affect the safety, utility, or efficiency of the airport" – were irrelevant to the City's opportunity cost of dedicating 1780.3 acres of its land for airfield use at LAX. The City claimed that it was therefore entitled to charge landing fees at LAX based on the FMV of the airfield land because FMV is the measure of its opportunity cost. This time, a different panel of the court of appeals from the one that heard *LAX I* denied the City's petition.

The court of appeals presented two rationales for its decision. First, it adopted DOT's "no opportunity, hence

no opportunity cost" rationale. App. 9a-13a. The court of appeals concluded that the two grant conditions mean that the City has no lawful opportunity to devote LAX to alternative uses, and therefore that it was unreasonable for the City to include a FMV rental charge to recover opp ›rtunity costs. The court of appeals rejected the claim that DOT's "no opportunity, hence no opportunity cost" rationale impermissibly added a new condition to the City's grant assurances and therefore is contrary to the "clear statement" requirement of *Pennhurst*. App. 13a. The court of appeals defended its conclusion by tersely stating that the prohibition against charging a FMV rent was not a new restriction but, rather, a "*consequence* of an unambiguously imposed condition – that the airport would be kept open for public use – that was present from the outset." App. 13a (emphasis in original).

The court of appeals also adopted DOT's other rationale – that even if the City did incur opportunity costs by devoting three square miles of its prime real estate to airport use, "those costs are already covered by the existing 'benefits' enjoyed by the City" as a result of operating LAX. App. 13a-15a. The City had argued that under a compensatory rate methodology, the reasonableness of *airfield* rates is to be judged on the basis of *airfield* costs, not on the basis of the overall economic performance or amorphous public benefit of the airport enterprise. Finding that it was proper to take these other considerations into account in determining whether the landing fees were reasonable, the court of appeals also rejected the City's argument that, by so doing, DOT was impermissibly challenging the City's right – recognized in *Kent County* and codified in 49 U.S.C. § 47129 – to use a compensatory rate methodology. App. 14a.

Finally, while the court of appeals recognized the right of municipalities such as the City to advance regulatory takings claims, App. 16a, it nevertheless rejected the City's claim by holding that the City would only be entitled to a hearing before DOT if the City had alleged that the financial integrity of LAX taken as a whole would be jeopardized unless it could use FMV to value its airfield land for rate-setting purposes. App. 15a-17a.

5. The City and Intervenor ACI-NA petitioned the court of appeals for rehearing and suggested rehearing *en banc*. The petitioners argued that the decision below should be withdrawn on a variety of grounds including the fact that the decision was irreconcilable with the panel decision in *LAX I*. In *LAX I* the court of appeals rejected DOT's position that the City was barred by operation of law from including in its airfield rate base the opportunity cost of devoting its land to airfield use – as measured by FMV. In addition, the petitioners argued that the decision below was inconsistent with this Court's decision in *Pennhurst*, in that it imposed new restrictions on the City that were not unambiguously set forth in the grant conditions, and also inconsistent with *Kent County*, in that the derived benefits rationale adopted by the panel impermissibly restricted the City's right to set fees at LAX using a compensatory fee methodology.

Although those petitions were rejected on June 18, 1999, *per curiam*, Judge Silberman, author of the court of appeals' opinion in *LAX II*, filed a separate statement concurring in the denial of rehearing *en banc*, and Judge Williams, joined by Judge Ginsburg – two of the three judges from the *LAX I* panel which granted the City's

first petition for review – filed a separate statement dissenting from the court's decision.[12] App. 109a-117a.

In his colorful concurring statement in which he chided Judges Williams and Ginsburg for their dissenting statement, Judge Silberman defended the panel decision as being required under "a deferential standard of review." App. 111a. As Judges Williams and Ginsburg point out in their dissenting statement, however, the panel's conclusion "that if some exogenous circumstance blocks application of a resource to other uses, it follows that the use of opportunity cost is inappropriate . . . is surely a non sequitur," and "the [panel's] conclusion that use of historical cost was 'a consequence of an unambiguously imposed condition,' 165 F.3d at 978, [also] appears to me a non sequitur." App. 114a.

REASONS FOR GRANTING THE WRIT

I. THE COURT OF APPEALS' DECISION WOULD PERMIT FEDERAL AGENCIES TO IMPOSE RESTRICTIONS OR OBLIGATIONS DERIVED ONLY BY IMPLICATION FROM GENERALLY-WORDED GRANT CONDITIONS, WHICH IS CONTRARY TO *PENNHURST* AND IN CONFLICT WITH DECISIONS OF THE FOURTH AND SEVENTH CIRCUITS

In *Pennhurst*, this Court held that when Congress legislates under its spending power, any grant conditions it imposes must unambiguously inform the grant recipient of the consequences of accepting federal funds. 451

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[12] Three of the eleven active judges on the Court of Appeals for the District of Columbia Circuit – including Judge Edwards who sat on *LAX I* – did not participate in the decision to deny rehearing *en banc*. App. 110a.

U.S. at 17. As this Court held, a grant recipient cannot voluntarily and knowingly accept the conditions if it is "unaware of the conditions or is unable to ascertain what is expected of it. . . . [I]f Congress intends to impose a condition on the grant of federal moneys, it must do so unambiguously."[13] *Id.*

The court below, however, instead deferred to DOT's principal justification in the *Remand Decision* for rejecting the City's use of FMV to value the airfield land at LAX – a justification derived by implication from the City's grant assurances, which DOT contended had as their inevitable consequence that there were no opportunity costs associated with dedicating the airfield land to airline use. This result is contrary to this Court's decision in *Pennhurst*, and is in conflict with the Fourth Circuit's *en banc* opinion in *Virginia Department of Education v. Riley*, 106 F.3d 559 (4th Cir. 1997) (*per curiam*, adopting the dissenting panel opinion of Luttig, J.), and with the Seventh Circuit's opinion in *Doe v. Oak Park & River Forest High School District*, 115 F.3d 1273 (7th Cir. 1997).

1. In upholding the *Remand Decision* because "we cannot say it was irrational," App. 11a, the court of appeals applied an improperly deferential standard to the review of agency action based upon the terms of a grant condition. Indeed, it is clear that, although the court of appeals did not cite to the case, it applied *Chevron* deference to DOT's decision. The court of appeals acknowledged that the City's use of FMV has substantial

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[13] In applying *Pennhurst*, this Court has consistently set a high standard for establishing whether a grant condition unambiguously imposes obligations on state and local government grant recipients. *See, e.g., Blessing v. Freestone*, 520 U.S. 329 (1997); *Suter v. Artist M.*, 503 U.S. 347 (1992).

economic support by stating that "an economist formulating an efficient plan for regulating [LAX's airfield] might well take the City's view," App. 10a, but nevertheless deferred to DOT's contrary conclusion. Judge Silberman, author of the opinion below, went even further in the separate statement he filed concurring in the denial of the petitions for rehearing *en banc*. In response to Judges Williams and Ginsburg's dissenting statement, in which they explained why the City's "proposed use of opportunity cost is reasoned," App. 113a, Judge Silberman responded as follows:

> By contrast, the panel, although recognizing that economists (or we) might disagree with the Department's rejection of opportunity cost pricing in this case, did not think that warranted us, as a reviewing court *under a deferential standard of review*, to object to the Department's decision. *City of Los Angeles*, 165 F.3d at 977.

App. 110a-111a (emphasis added).

The court of appeals should have applied a more demanding standard to DOT's action: because a governmental grant recipient, such as the City, may not be forced to comply with restrictions unless they are unambiguously expressed in the grant, DOT's action can only be sustained if the court concludes that the agency action was based upon language in the grant condition that informed the governmental grant recipient in clear and unambiguous terms of the restriction or obligation to which it was subjecting itself. *Pennhurst*, 451 U.S. at 17-18.

The court of appeals attempted to avoid the fact that the grant conditions at issue did not explicitly prohibit the City from charging FMV rents by contending that the prohibition was not a new condition, but rather merely a "consequence" of an existing grant condition that

required the City to make LAX "available for public use on fair and reasonable terms." App. 13a. If permitted to stand, however, the court of appeals' rationale would enervate *Pennhurst* by permitting federal agencies to impose – years later – newly formulated restrictions or obligations on state and local government grantees based upon the supposed "consequences" of grant conditions rather than upon clear and unambiguous grant language, so long as the agencies' rationale is sustainable under *Chevron*.[14]

The decision below is in conflict on this issue with the *en banc* decision of the Fourth Circuit in *Virginia Department of Education v. Riley*, 106 F.3d 559 (1997), a case which has been subsequently followed by the Seventh Circuit in *Doe v. Oak Park & River Forest High School District*, 115 F.3d 1273 (1997) (finding "the rationale and result" in *Riley* persuasive).[15]

In *Riley*, the court of appeals reviewed a Department of Education ("DOE") order interpreting a condition for grants under Part B of the Individuals with Disabilities

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[14] This result is also in conflict with *Bennett v. New Jersey*, 470 U.S. 632 (1985), in which this Court, in finding that when a grant recipient applied for and received grant funds, it "had no basis to believe that the propriety [of its actions] would be judged by any standards other than the ones in effect at the time," *id.* at 640, held that "changes in the substantive standards governing federal grant programs do not alter obligations and liabilities arising under earlier grants," *id.* at 641.

[15] *See also Harris v. James*, 127 F.3d 993, 1009 (11th Cir. 1997) ("To hold otherwise would be inconsistent with the driving force of Supreme Court precedent requiring a *Congressional* intent to create federal rights and with the Supreme Court's directive that courts must find that Congress has *unambiguously* conferred federal rights on the plaintiff.") (emphasis added).

Education Act ("IDEA") which required a state to " 'assure[ ] all children with disabilities the right to a free appropriate public education.' " 106 F.3d at 560 (quoting 20 U.S.C. § 1412(1)). The DOE order had construed the grant language as prohibiting Virginia from maintaining "a policy – like that the State maintains for its non-disabled students – pursuant to which it could cease providing free education to disabled students who are expelled or suspended long-term for behavior unrelated to their disabilities." *Id.* at 560.

The Fourth Circuit, by a vote of six to two, overturned the DOE order on the ground "that IDEA at most only *implicitly* conditions the States' receipt of funds upon the continued provision of educational services to students expelled for misconduct unrelated to their handicaps," whereas, because what is at issue is "congressional conditioning of the States' receipt of federal funds," *South Dakota v. Dole*, 483 U.S. 203 (1987), and *Pennhurst* require that "in order for the States to be bound by a condition upon the receipt of federal monies, the Congress must have affirmatively imposed the condition in clear and unmistakable statutory terms." *Riley*, 106 F.3d at 562-63 (emphasis added); *see also id.* at 566-68.[16]

The Fourth Circuit clearly recognized that "[i]n the end, this case is about the permissible reach of federal power under the Spending Clause in a time when the

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[16] A plurality of the Fourth Circuit also stated that "[a] substantial constitutional question under the Tenth Amendment would be presented were the Secretary of Education's interpretation of the IDEA upheld," since the withholding of Virginia's entire IDEA allotment for refusal to provide tutors to 126 disabled students verged on "impermissible coercion." 106 F.3d at 561.

several States have become increasingly dependent upon the federal government for funds." *Id.* at 570. Here, however, the court below took the opposite tack, adopting the same general approach as the dissent in the Fourth Circuit *en banc* decision. That approach would hold that *Chevron* is controlling over the pre-*Chevron* decision in *Pennhurst* and would require that a reviewing court defer to the reasonable statutory interpretation of an administrative agency regardless of whether that interpretation is clearly and unambiguously set forth in grant conditions. *Compare, e.g., id.* at 580-81 *with* App. 11a ("[O]ur review is still a matter of determining whether the agency's final decision 'was based on a consideration of relevant factors and whether there has been a clear error of judgment.' " (citation and quotation omitted)).

This Court should resolve the conflict between the D.C. Circuit, on the one hand, and the Fourth and Seventh Circuits, on the other, on the unsettled question whether, in reviewing a restriction or obligation imposed by a federal agency on a governmental grantee based upon grant conditions, the standard for review is one derived from *Pennhurst*, under which the grant recipient must have received clear and unambiguous notice of the restriction or obligation, or one derived from *Chevron*, which requires deference to any reasonable construction of the grant statute by an administrative agency.

2. It is uncontroverted that the grant conditions at issue do not expressly prohibit the use of FMV to value airport assets for rate-setting purposes. None of the conditions contained in the grants accepted by the City for use at LAX between 1982 and 1994 even mention either historic costs or FMV much less require the City to use

historic costs to establish reasonable rental charges, landing fees or other charges. It is also undisputed that, until the Interim Policy in 1995, DOT had no regulation or policy governing airport rate methodologies and certainly nothing requiring airfield land to be valued using historic cost as opposed to FMV, or any other cost basis. *See* App. 23a.[17]

One of the grant conditions relied upon by DOT merely requires that LAX "be available for public use on fair and reasonable terms." 49 U.S.C. app. § 2210(a)(1) (App. 155a). The other simply precludes the City from making any alteration to LAX's layout plan unless DOT decides that the change will not "adversely affect the safety, utility, or efficiency of the airport." 49 U.S.C. app. § 2210(a)(15)(C) (App. 161a). Given the language of these conditions, it is not surprising that even the panel decision below did not hold that the grant conditions themselves "unambiguously" imposed the requirement that airfield land at LAX be valued at historic cost in calculating landing fees, but rather argued that the restriction was a "consequence" of the grant conditions. App. 13a.[18]

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[17] Because the FMV-based charge for airfield land at LAX was first imposed in 1993, DOT has never sought to apply either the subsequently promulgated Interim Policy or the Final Policy to the present case. In any event, the prohibition against FMV-based charges for airfield land in the Interim Policy which was also part of the Final Policy was vacated by the D.C. Circuit in 1997, *Policy Appeal*, App. 119a, 137a, and no successor regulation has even been proposed by DOT. *See* App. 8a-9a.

[18] DOT's *Remand Decision* and the decision below are both necessarily premised on a reading of the grant conditions to impose a continuing duty on the City to keep LAX in operation. However, such a duty is not clearly and unambiguously stated in any of the grant conditions, but can at best only be *implied* from grant conditions dealing with other matters.

Remarkably, at the same time DOT has contended that the following seemingly inconsistent "consequences" were also implicit in the two generally worded grant conditions on which they rely to prohibit use of FMV to value airfield land: (1) that the City is *required* to charge FMV for non-aeronautical land (to comply with the grant conditions that requires the airport to be as self-sustaining as possible, 49 U.S.C. app. § 2210(a)(9) (App. 158), *see supra* note 3), as DOT has recently announced in its Policy and Procedures Concerning the Use of Airport Revenue, 64 Fed. Reg. 7696, 7721 (Feb. 16, 1999), and (2) that the City will be required to use some other yet-to-be-determined scheme for non-airfield, aeronautical land, a subject of DOT's Advanced Notice of Proposed Policy, 63 Fed. Reg. 43228 (Aug. 12, 1998). While these additional "consequences" are not at issue in the present case, they demonstrate the arbitrary and unbounded results which the court of appeals' approach would sanction.[19]

3. Under the circumstances, the court of appeals' contention that the newly imposed restrictions on the City were merely a "consequence" of general grant conditions is nothing more than a convenient – and ultimately unavailing – way to permit DOT to evade the strictures of

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[19] The City's use of FMV to value other portions of LAX without criticism from air carriers or action by DOT – both before and concurrently while entering into AIP grant agreements in the 1982 to 1994 period – underscores why the grant conditions could not have unambiguously informed the City that a FMV-based rental charge for airfield land would have been prohibited. In fact, DOT acknowledges that fair market valuation of land and assets has long been used to arrive at fees for non-airfield portions of airports throughout the nation. *See, e.g.*, Final Policy, 61 Fed. Reg. at 32007 (June 21, 1996).

Pennhurst which prohibits federal agencies from imposing obligations on grant recipients based on other than clear and unambiguous grant conditions.

Indeed, DOT's implied prohibition on the use of FMV conflicts with congressional intent in the FAAAA to minimize federal interference with local airport rates and charges policies. Specifically, Congress did not authorize DOT to impose on airport grantees any restrictions or obligations it considered "reasonable." To the contrary, Congress limited DOT's authority to disallowing airport fees found *not* to be "reasonable" and specifically prohibited DOT from setting the level of the fee. 49 U.S.C. § 47129(a)(3) (App. 149a); *see also infra* p. 28 note 23.

If the decision below is permitted to stand, federal agency authority based on the Spending Clause will be permitted to expand dramatically. Unconstrained by *Pennhurst*'s requirement that grant conditions be set forth clearly and unambiguously, federal agencies would be permitted to impose on state and local government grantees new and unforeseen conditions that are supposedly *implied* from, but not actually stated in, grant statutes. This would irrevocably – and unwisely – alter the balance of power in our federal system, shifting power to the federal government in the absence of the requisite clearly stated Congressional intent.

For all these reasons, a writ of certiorari should issue to resolve the conflict between the decision below and *Pennhurst*, and to resolve the circuit split between the D.C. Circuit, on the one hand, and the Fourth and Seventh Circuits, on the other, concerning the appropriate standard for judicial review of agency interpretations of grant conditions.

II. THE COURT OF APPEALS' DERIVED BENEFITS ANALYSIS IS IN CONFLICT WITH *KENT COUNTY* AND 49 U.S.C. § 47129, BOTH OF WHICH ALLOW AIRPORT SPONSORS TO USE A COMPENSATORY METHODOLOGY TO SET LANDING FEES

In *Kent County*, this Court upheld the right of public airport owners, such as the City, to use "compensatory" rate-setting methods to recover through landing fees the economic costs of airfield facilities the airlines use. 510 U.S. at 369-74. The alternative justification (adopted by both DOT and the court of appeals) for rejecting the City's use of FMV in setting its landing fees – that any opportunity costs associated with the use of the airfield are somehow "covered" by non-airfield revenue or derived benefits – is inconsistent with *Kent County*.[20] If, as the City contends, its opportunity costs (as measured by FMV) would otherwise be allowable, DOT cannot lawfully forbid the City from using FMV simply because the airport *as a whole* generates net income or substantial municipal benefits from its total operations. The

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[20] The claim that the airport's overall revenues, or the City's aggregate benefits, can be taken into account, and deemed amply to compensate for any shortfall in airfield revenue, is reminiscent of the approach taken by the Seventh Circuit in *Indianapolis Airport Auth. v. American Airlines, Inc.*, 733 F.2d 1262, 1267-68 (7th Cir. 1984). This misconception of compensatory ratemaking was repudiated by this Court in *Kent County*, 510 U.S. at 371-72. The Court overruled *Indianapolis Airport* and affirmed the ability of airport owners to use the "multiple cash register" compensatory approach to airport rate-setting, in which the airport is divided into different revenue-producing cost centers (such as the airfield) that each must pay its own way. *Id.* at 369-72; *Indianapolis Airport Auth.*, 733 F.2d at 1270.

approach taken by DOT and the court of appeals cannot be squared with the essential premise of compensatory rate-setting, approved by this Court in *Kent County*, 510 U.S. at 369-72, and later expressly sanctioned by Congress in 49 U.S.C. § 47129(a)(2) (App. 149a).[21]

The airlines brought their complaint in *Kent County* in an effort to establish as a matter of law that compensatory rate-making is unreasonable *per se*. *See Northwest Airlines, Inc., v. County of Kent, Mich.*, 738 F. Supp. 1112, 1113 (W.D. Mich. 1990), *aff'd in part, rev'd in part*, 955 F.2d 1054 (6th Cir. 1992), *aff'd*, 510 U.S. 355 (1994). The airlines claimed that airport owners are required to recognize the "interdependency" of aeronautical and non-aeronautical activities, *i.e.*, there would not be much (if any) non-aeronautical income if passengers were not using the airport to fly to or from the city where the airport is located. The airlines argued that airport owners should be required to offset their landing fees and terminal rents to account for any "surplus" non-aeronautical income. *See Kent County*, 738 F. Supp. at 1114; *Northwest Airlines, Inc.*

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[21] The decision by the court of appeals rejecting the City's claims under the Takings Clause also reflects this erroneous approach. The City claimed that if it were restricted to the recovery of its historical airfield costs, without any provision for a rate of return, an unlawful taking would be effected. Unlike DOT, the court of appeals acknowledged that even though it is a public landowner, the City could bring a regulatory takings claim. App. 16a. The court of appeals was wrong, however, when it held that to pursue such a claim, the City would have to allege that the "financial integrity of LAX" *as a whole* would be jeopardized if the contested FMV charge were disallowed. App. 16a-17a. Under *Kent County*, the existence *vel non* of a compensable regulatory taking of the airfield land should not turn on whether a property owner is able to generate revenue from independent sources.

v. County of Kent, Mich., 955 F.2d 1054, 1057 (6th Cir. 1992), *aff'd*, 510 U.S. 355 (1994). This Court rejected the airlines' theory and affirmed that compensatory rate-setting is not inherently unreasonable. *Kent County*, 510 U.S. at 369-70.

Under a compensatory rate-setting regime, as upheld in *Kent County*, an airport is divided into a number of functional cost centers (such as the airfield), and the rates for the use of the facilities in each cost center are separately calculated to recover from each aeronautical user its fair share of the costs attributable to the facility without taking into account the costs or revenues associated with other cost centers. *E.g.*, App. 3a; App. 81a-82a; *Kent County*, 510 U.S. at 359.[22] Under this system, the existence of so-called "surplus" revenue elsewhere within the airport, or the creation of alleged "benefits" outside the airport, does not, and cannot, affect the reasonableness of a compensatory rate. Thus, the reasonableness of *airfield* rates is to be judged in relation to *airfield* costs, not on the basis of the overall economic performance – or beneficial impact – of the airport enterprise. *Kent County*, 510 U.S. at 369-72.

Even if it were true, as DOT and the court of appeals have assumed, that the use of the entire LAX property as

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[22] It is typical for airport owners that use the compensatory method to establish a separate cost center for the airfield which is expected "to pay its own way" through the collection of landing fees. *See, e.g., Kent County*, 510 U.S. at 359-60; *Denver v. Continental Air Lines, Inc.*, 712 F. Supp. 834, 835 (D. Colo. 1989); *Raleigh-Durham Airport Auth. v. Delta Airlines*, 429 F. Supp. 1069, 1078-79 (D.N.C. 1976). Here, the Airlines never challenged the City's establishment of a separate airfield cost center at LAX.

an airport generates on an enterprise basis more aeronautical and non-aeronautical revenue for the City than any alternative use would yield, the City will still incur opportunity costs in dedicating its airfield land to airport use unless the *landing fees* cover the FMV of the land. *See* App. 115a ("But the panel never explains, and I cannot understand, why the existence of those benefits undercuts the reasons for using opportunity cost.") (Williams, J., *dissenting*). The existence of opportunity costs in dedicating land to airfield use simply does not depend upon the uncertain and risky revenue streams the City may be able to generate from *other* airport assets or upon the collateral benefits the City may derive from having a successful airport in its midst. Neither *Kent County* nor 49 U.S.C. § 47129(a)(2) permits DOT to disallow airfield opportunity costs based on the aggregate revenues or benefits obtained from the use of *all* aeronautical and non-aeronautical assets.[23]

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[23] It is true that in *Kent County* the Supreme Court invited DOT to adopt a reasonableness standard that might entail "more rigorous scrutiny" than the Court had articulated under the dormant Commerce Clause. *Kent County*, 510 U.S. at 368 n.14. The Court cautioned, however, that any standard DOT adopts must represent "a permissible construction of the statute." *Id.* When Congress subsequently enacted Section 47129(a)(2), codifying the right of airports to use a compensatory method, it expressly foreclosed the possibility that DOT would assess the reasonableness of compensatory aeronautical charges on the basis of non-aeronautical revenue.

Indeed, in the past, DOT has acknowledged that Section 47129(a)(2) bars airline claims that non-aeronautical revenues should be taken into account in assessing the reasonableness of compensatory charges. *See, e.g.*, Interim Policy, 60 Fed. Reg. 6906, 6908-09 (noting that the Air Transport Association of America's position that revenues derived from non-aeronautical

Accordingly, under both *Kent County* and 49 U.S.C. § 47129, it was improper for DOT and the court of appeals to rely upon the existence of "surplus" non-aeronautical revenue at LAX or the overall benefits the City derives from LAX in ruling that the City had no opportunity cost or, alternatively, that any opportunity costs were adequately compensated by non-airfield revenues (or benefits). A writ of certiorari should be granted to resolve the conflict between *Kent County* and the decision below.

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activities should be considered was "specifically rejected by the Supreme Court in the *Kent County* decision" and that "§ [47129] expressly preserves an airport proprietor's right to use a compensatory methodology"); Final Policy, 61 Fed. Reg. 31994, 31999-32000 (DOT "will not require cross-crediting of revenues, because section 47129 does not permit us to do so."). In accordance with Section 47129, the Final Policy provides in ¶2.1 that "[f]ees may be set according to a 'residual' or 'compensatory' rate-setting methodology . . . " and in ¶2.1.1 that "[a]eronautical users may receive a cross-credit of non-aeronautical revenues only if the airport proprietor agrees." 61 Fed. Reg. 32019.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

APPENDIX A

CITY OF LOS ANGELES,
et al., Petitioners

v.

UNITED STATES DEPARTMENT OF TRANSPORTATION, et al., Respondents.

Airports Council International – North America, et al., Intervenors.

No. 98-1071

United States Court of Appeals,
District of Columbia Circuit.

Argued Jan. 7, 1999.

Decided Feb. 5, 1999.

Steven S. Rosenthal argued the cause for petitioners. With him on the briefs were Jeffery A. Tomasevich, Scott P. Lewis, Kenneth W. Salinger, Ronald N. Wilson, Stanley A. Zamel, and Breton K. Lobner. Leilani F. Battiste entered an appearance.

Thomas L. Ray, Senior Trial Attorney, United States Department of Transportation, argued the cause for respondents. With him on the brief were Joel I. Klein, Assistant Attorney General, United States Department of Justice, Robert B. Nicholson and Marion L. Jetton, Attorneys, Nancy E. McFadden, General Counsel, United States Department of Transportation, and Paul M. Geier, Assistant General Counsel.

Jonathan S. Franklin argued the cause for intervenors Air Transport Association of America, et al. With him on the brief was Allen R. Snyder.

G. Brian Busey, Anthony L. Press, and Patricia A. Hahn were on the briefs for intervenor Airports Council International – North America.

Before: SILBERMAN, SENTELLE and RANDOLPH, Circuit Judges.

Opinion for the Court filed by Circuit Judge SILBERMAN.

SILBERMAN, Circuit Judge:

The City of Los Angeles increased the landing fees at Los Angeles International Airport, and the airlines challenged those fees as unreasonable before the Department of Transportation. The DOT set aside the increased fees, reasoning that the City's attempt to recoup its "opportunity costs" through the fees was impermissible as a matter of statute. In *City of Los Angeles v. DOT*, 103 F.3d 1027 (D.C.Cir.1997), we rejected that statutory interpretation and remanded for the DOT to consider the opportunity cost issue as a matter of policy. The DOT did so, concluding that the City's claimed entitlement to recover its opportunity costs was unreasonable, and rejected the fees. The City petitions for review. We deny the petition.

I.

Until 1993, the City of Los Angeles, pursuant to a contractual agreement with the airlines, established landing fees at the Los Angeles International Airport (LAX) based on a residual methodology. Under that technique,

the City estimated the revenue and cost attributable to non-aeronautical operations – such as parking contracts and concession franchising – for the coming fiscal year. Expected nonaeronautical surplus, if any, was then applied toward the anticipated cost of aeronautical operations. Landing fees were set (based on estimated landed weight) at a sufficient level to make up for the remaining aeronautical cost. In 1992, the last year in which the City used this methodology, the fee was $.51 per 1,000 pounds of landed weight. In 1993, the expiration of the City's contract with the airlines opened the door for the City to adopt the potentially more lucrative compensatory fee methodology. That approach treats aeronautical operations separately from non-aeronautical operations; the airport sets landing fees at a sufficient level to compensate it for the *entirety* of its aeronautical costs, and any surplus or deficit from non-aeronautical operations is irrelevant.

The City also decided in 1993, for the first time, to include in its estimated aeronautical costs a charge reflecting the current annual fair market rental value of the land on which the airfield rests. The City thought itself entitled to recover this "opportunity cost," for only then would the City be compensated fully for the cost of using the land as an airport instead of pursuing its alternative opportunity to earn profits by renting the land.[1]

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[1] A leading economics text defines "opportunity cost" in this way: "[M]aking a choice in effect costs us the opportunity to do something else. The alternative forgone is called the opportunity cost. . . . " PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, ECONOMICS 128 (16th ed.1998).

The City appraised the current fair market value of the land at $150,000 per acre. (The City had purchased most of the 1,780.3 acres on which the airport is built over 50 years ago at an average price of $2,427 per acre.) Adjusting for the effects of federal grants and converting to an annual rental value, the City arrived at a figure of $8,348 per acre per year, or $14,861,900 per year for the entire 1,780.3 acres occupied by the airport. Putting this fair market rental value, among other costs, into its compensatory fee calculation, the City computed a landing fee of $1.56 per 1,000 pounds of landed weight (effective July 1, 1993), an increase of more than $1.00 over the 1992 fee. When contract negotiations looking to a compensatory fee agreement between the City and the airlines broke down, the City unilaterally imposed the $1.56 fee by ordinance, informing the airlines that they could not land at LAX unless they paid the increased fee.

The airlines challenged the fee increase pursuant to an expedited administrative procedure in which the Department of Transportation has authority to set aside unreasonable fees. *See* 49 U.S.C. § 47129 (1994); *see also* Anti-Head Tax Act, 49 U.S.C. § 40116(e)(2) (1994) (providing that a political subdivision of a State may levy or collect "reasonable . . . landing fees"); 49 U.S.C. § 47107(a)(1) (1994) (requiring federal airport grant recipients to assure the DOT in writing that "the airport will be available for public use on reasonable conditions"). The Department determined the fee unreasonable, reasoning that the Anti-Head Tax Act's "requirement of reasonable fees . . . mandat[es] the use of historic cost for airfield land" – *i.e.*, the original acquisition cost of the land on which the airport was built – and thereby forbids

consideration of opportunity cost. *Los Angeles Int'l Airport Rates Proceeding*, Order No. 95-6-36, at 24 (June 30, 1995). In the meantime, the City had announced a new landing fee in 1995 of $2.06 per 1,000 pounds of landed weight (effective July 1, 1995), again including among its costs its claimed "opportunity cost," *i.e.*, the forgone fair rental value of the airfield land. The airlines challenged this fee before the DOT, and the Department set the fee aside for the same reason given in rejecting the 1993 fee. *Second Los Angeles Int'l Airport Rates Proceeding*, Order No. 95-12-33 (December 22, 1995).

In *City of Los Angeles v. DOT* (*LAX I*), 103 F.3d 1027 (D.C.Cir.1997), we granted the City's petition for review of the Department's decision regarding the 1993 fee. (We had stayed proceedings relating to the 1995 fee pending our review of the Department's decision on the 1993 fee.) We concluded that the Department had no basis for its view that the Anti-Head Tax Act *forbade* the consideration of opportunity costs in determining the reasonableness of landing fees and *permitted* only the consideration of historic costs. *Id.* at 1032. Although we noted that "[h]istoric cost is . . . one permissible measure of costs in cost-of-service rate-making," we rejected the "Secretary's view of historic cost as the apodictically indicated measure of 'actual cost.' " *Id.* Accordingly, we vacated the Secretary's decision and remanded "for his fuller consideration of the respective merits of the historic cost and [opportunity cost] methodologies here at issue." *Id.* We granted the Department's request for a remand of the 1995 fee proceeding to conduct a similar policy evaluation of the competing methodologies. *See Air Transport Ass'n of Am.*

v. DOT, No. 96-1018 (D.C.Cir. March 7, 1997) (per curiam order).

On remand, the DOT consolidated the 1993 and 1995 fee proceedings. As before, the Department held that the 1993 and 1995 fees should be set aside because it was unreasonable for the City to recover its claimed "opportunity cost." *Los Angeles Int'l Airport Rates Proceeding and Second Los Angeles Int'l Airport Rates Proceeding* (*Remand Decision*), Order 97-12-31 (December 23, 1997). But this time the Department rested its decision explicitly on policy grounds. It pointed to the airport's obligation as a federal airport grant recipient to keep the airport "available for public use," 49 U.S.C. § 47107(a)(1), and to another provision that bars a grant recipient from making any alteration to the airport's layout unless the Secretary decides that the change will not "adversely affect the safety, utility, or efficiency of the airport," *id.* § 47107(a)(16)(C). *See Remand Decision* at 13. These provisions forbid the City from converting the airfield land to rental property; the City at present has no lawful opportunity to use the land in any capacity other than as an airport. (Although the Department and the City seem to disagree on precisely when the City's grant assurance obligation will expire, it is undisputed that the grant assurance obligation is currently in force.) The Department therefore concluded that it would be unreasonable for the City to recover compensation through its landing fees for a "lost opportunity" that does not lawfully exist. *See id.* at 14.

Alternatively, the DOT held that even if the City were thought to incur opportunity costs, the fees should be set aside because the City's "benefits" from operating LAX

already sufficed to cover the City's opportunity costs. The Department viewed the City, rather than the airport, as the relevant economic actor; pursuing the rental opportunity would require the City either to build a new airport (or expand an existing minor airport such as Long Beach or Orange County), or else simply to go without a major airport. The latter option, according to the Department, would entail an enormous loss to the City; a 1992 study quantified the benefits of LAX "in terms of jobs (402,000); direct, indirect, and induced economic impacts ($37 billion per year); and state and local taxes ($1.7 billion per year)." *Id.* at 17. And the City would sacrifice the current revenue the City earns from its airfield and non-airfield activities at LAX. In the Department's view, these losses far outweigh any reasonable forecast of rental revenue – the City's estimate of that revenue, recall, was a mere $14,861,900 per year. In short, the stream of benefits from using the land as rental property rather than as an airport would be smaller than the stream of benefits from operating the airport – *i.e.*, the opportunity cost of using the land as an airport was already being covered. And the Department thought the calculus would not be much different if the City, rather than going without a major airport, attempted to build a new major airport or expand existing minor airports. Relying on the City's own appraisal firm's report that the "relocation of the Los Angeles International Airport (LAX) is practically impossible" given the paucity of alternative airport development sites and the prohibitive costs of acquiring such a site, the Department concluded that once these costs were taken into account, the net

profit from renting the LAX land would again be outweighed by the benefits of using the LAX land as an airport. *Id.* at 18-19. In the end, the Department concluded that the City's analysis of its opportunity costs – which treated only the *airport* as the relevant economic actor and considered only the annual rental income of $14,861,900 – was overly simplistic, and therefore rejected the City's attempt to include its self-described "opportunity costs" in calculating its landing fees.

We should briefly mention a related proceeding, the DOT's effort to fulfill its statutory mandate under 49 U.S.C. § 47129(b)(2) to publish final regulations, policy statements, or guidelines establishing the "standards or guidelines that shall be used by the Secretary in determining . . . whether an airport fee is reasonable." In June 1996, the Secretary published a regulation entitled the "Policy Regarding Airport Rates and Charges." *See* 61 Fed.Reg. 31,994 (June 21, 1996). The regulation required airports to value their *airfield* assets at historic cost, but allowed airports to use "any reasonable methodology" in valuing their *non-airfield* assets. *Id.* In *Air Transport Association v. DOT*, 119 F.3d 38 (D.C.Cir.1997), we vacated the regulation, challenged both by the airlines and Los Angeles, because, *inter alia*, the Secretary "simply ha[d] not explained why fair market valuation may be appropriate for other portions of the airport, but too difficult to use in valuing airfield assets." *Id.* at 44. The Secretary is presently in the process of formulating a new regulation on airport fees, and has issued an advance notice of proposed rulemaking asking for comments on what cost methodologies should be required for airfield and non-airfield fees. *See* 63 Fed. Reg. 43,228 (Aug. 12, 1998). The

City contends that our vacatur of the Department's regulation in *Air Transport Association* somehow casts doubt on the *Remand Decision* presently before us. But the Department did not rely on its vacated regulation, *see Remand Decision* at 8, and has not yet adopted a new regulation on the appropriate methodology for non-airfield fees as compared to airfield fees.

II.

The City and the Department before us principally dispute the reasonableness of the City's *methodology* of fee calculation, not the reasonableness of the *magnitude* of the resulting fees.

A.

Reiterating its first reason for rejecting the City's fee methodology, the Department submits that it is unreasonable to attempt to include as an airfield cost the "opportunity cost" of employing the land as an airport rather than as rental property, for the proposed opportunity does not lawfully exist at present. As one of the members of the panel observed, in paraphrasing the DOT's argument, the City is like an owner of a hot dog stand who claims his opportunity cost is the revenue he would earn by selling cocaine rather than hot dogs. The City contends, however, that the Department has adopted an erroneous conception of opportunity cost; for an economist, we are told, the present impossibility of pursuing the opportunity to rent the airfield land does not mean that no opportunity cost has been incurred.

At bottom, the parties' dispute as to the concept of opportunity cost seems to rest on a single question: Should the legal barrier to pursuing the opportunity be treated as immutable? If opportunity costs are measured as of now and the grant assurance obligation is viewed as fixed, then the Department's view would seem inevitable. For then the City would have no opportunity to use the land in any non-airport capacity – the City at least would face enormous transition costs (the cost of violating the law or perhaps of buying a release from the obligation) in pursuing the opportunity, which alone could render the potential profit from that opportunity small or even negative. But if we ignore (*i.e.*, treat as changeable at zero cost) the present legal hurdle to pursuing the opportunity, then the City's position is much stronger.

To be sure, an economist formulating an efficient plan for regulating the City's monopoly over landing space might well take the City's view, treating all regulatory tools – including existing grant assurance obligations – as easily changeable. *Cf.* William J. Baumol & J. Gregory Sidak, Transmission Pricing and Stranded Costs in the Electric Power Industry 53 (1995). But the airlines' expert suggested otherwise when he testified that "[s]ometimes the opportunity is virtually nil, in which case there is no opportunity cost." In any event, that some or many economists would disapprove of the Department's approach does not answer the question presented to us. In reviewing the Department's order, we do not sit as a panel of referees on a professional economics journal, but as a panel of generalist judges obliged to defer to a reasonable judgment by an agency acting pursuant to congressionally delegated authority. *See Air Canada v. DOT*, 148 F.3d

1142, 1151 (D.C.Cir.1998); *LAX I*, 103 F.3d at 1031 (citing *Northwest Airlines v. County of Kent*, 510 U.S. 355, 366-68, 114 S.Ct. 855, 127 L.Ed.2d 183 (1994)); *see generally Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43, 103 S.Ct. 2856, 77 L.Ed.2d 443 (1983). The City submits that our review should be more strict given that the Department arrived at the same result on remand as it had reached in its initial decision, but that proposition strikes us as flatly inconsistent with the Chenery doctrine. *See SEC v. Chenery Corp.* (*Chenery I*), 318 U.S. 80, 63 S.Ct. 454, 87 L.Ed. 626 (1943); *SEC v. Chenery Corp.* (*Chenery II*), 332 U.S. 194, 200, 67 S.Ct. 1575, 91 L.Ed. 1995 (1947) ("We held no more and no less [in *Chenery I*] than that the Commission's first order was unsupportable for the reasons supplied by that agency."). To be sure, there is some support for the City's view in our cases. *See, e.g., Greyhound Corp. v. ICC*, 668 F.2d 1354, 1358 (D.C.Cir.1981). But as we have more recently explained, "[w]hile we are mindful that [the agency] has adhered to the position it first took in the decision that we remanded, *cf.* [*Greyhound*], our review is still a matter of determining whether the agency's final decision 'was based on a consideration of the relevant factors and whether there has been a clear error of judgment.' " *Competitive Enter. Inst. v. NHTSA*, 45 F.3d 481, 484 (D.C.Cir.1995) (quoting *State Farm*, 463 U.S. at 43, 103 S.Ct. 2856).

Here we cannot say it was irrational for the Department to treat the grant assurances as a given and evaluate the City's proposed methodology from that perspective. And the grant assurance obligations may in fact be a fixed point for the DOT. Although the Department has some control over grant assurances insofar as the grant

recipient *ab initio* promises the *Department* to keep the airport open for public use, *see* 49 U.S.C. § 47107(a)(1), it is unclear whether the Department is free at this stage to release an airport from its promise – to do so might violate the statute.[2]

The City argues that the Department's "no opportunity, hence no opportunity cost" rationale attempts an "end run" around our holding in *LAX I* that the Anti-Head Tax Act, 49 U.S.C. § 40116(e)(2), does not itself *proscribe* consideration of opportunity costs in establishing reasonable landing fees. *See LAX I*, 103 F.3d at 1032. The City explains that under the *Remand Decision*, no airport that accepts federal grants (and thus gives grant assurances) could ever justify the recovery of opportunity costs – the result is a "*per se* rule" against using opportunity costs in calculating landing fees, which is another way for the Department to claim that it is legally mandated to reject the opportunity cost methodology. But the Department did not say that it was obliged to take into account the federal grants. Even if it were, in *LAX I*, we addressed only the Anti-Head Tax Act and the expedited

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[2] In a contention related to its attack on the *Remand Decision* as economically unsound, the City argues that the airlines, as proponents of an order setting aside the fees, failed to carry the burden of persuasion assigned to them by the Administrative Procedure Act. *See* 5 U.S.C. § 556(d) (1994); *Air Canada*, 148 F.3d at 1155-56 (citing *Director, Office of Workers' Compensation Programs, Dep't of Labor v. Greenwich Collieries*, 512 U.S. 267, 272, 114 S.Ct. 2251, 129 L.Ed.2d 221 (1994)). We think this argument lacks merit, given that the airlines did introduce in evidence the City's grant assurances, and that the Department's conclusions turned on its own policy determination. *See Air Canada*, 148 F.3d at 1157.

review provision, *see LAX I*, 103 F.3d at 1032 ("Nothing in the Anti-Head Tax Act or [the expedited review provision] . . . prescribes an accounting rather than an economic conception of cost in airport ratemaking."), and did not analyze any argument based upon the federal airport grant provision.

Intervenor Airports Council International (ACI) points to a different alleged problem with the Department's "no opportunity, hence no opportunity costs" rationale: ACI submits that DOT has retroactively added new conditions to the City's grant assurances by relying on those grant assurances to deprive the City of the ability to recover its opportunity costs, which ACI claims conflicts with the "clear statement" requirement of *Pennhurst State School & Hospital v. Halderman*, 451 U.S. 1, 17, 101 S.Ct. 1531, 67 L.Ed.2d 694 (1981). But we do not view the Department's reasoning as adding new conditions to the grant. Rather, the Department focused on a *consequence* of an unambiguously imposed condition – that the airport would be kept open for public use – that was present from the outset.

B.

Even were we to hold the Department's first rationale unlawful, we would uphold its order. We cannot say – and the City does not seriously argue – that the DOT's alternative rationale, that if the City is deemed to incur opportunity costs, those costs are already covered by the existing "benefits" enjoyed by the City, is an unreasonable one. *See Air Canada*, 148 F.3d at 1142; *LAX I*, 103 F.3d at 1031; *State Farm*, 463 U.S. at 43, 103 S.Ct. 2856. The City

does argue that the Department's "comprehensive opportunity cost analysis" rationale runs into a separate legal problem. By taking into account the current non-airfield revenue at LAX in deciding whether the City's opportunity costs are presently covered, it is claimed that the Department deprives the City of its right to use the compensatory fee methodology by forbidding the City from valuing its airfield assets without considering non-airfield revenues.[3] The compensatory fee methodology, the City reminds us, was recognized by the Supreme Court in *Northwest Airlines*, 510 U.S. at 369, 114 S.Ct. 855, and codified by Congress, *see* 49 U.S.C. § 47129(a)(2) ("A fee subject to a determination of reasonableness under this section may be calculated pursuant to either a compensatory or residual fee methodology or any combination thereof."). This is a clever argument, but not persuasive because the Department in no sense adopted a general requirement that airports must credit their non-airfield surpluses toward their airfield costs. The DOT is only taking into account non-airfield revenues, as well as all other economic benefits the City enjoys, in determining whether Los Angeles really has an uncovered opportunity cost. It is the City itself, by using the opportunity costs concept, that has invited the Department to think broadly about how such costs should be measured. And we cannot hold that it was unreasonable for the DOT, when faced with a demand for an economic analysis, to

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[3] The compensatory fee methodology, recall, permits an airport to set landing fees at a sufficient level to cover its airfield costs and, unlike the residual methodology, does not require an airport to apply any surplus from non-airfield activities toward those airfield costs.

consider factors that an economist might take into account.[4]

III.

The City argues that the setting aside of its fees amounted to an unconstitutional taking. The question is entirely one of the adequacy of the fee the Department permits the City to charge; the Takings Clause has nothing to do with the methodology of ratemaking. *See Duquesne Light Co. v. Barasch*, 488 U.S. 299, 314, 109 S.Ct. 609, 102 L.Ed.2d 646 (1989); *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602, 64 S.Ct. 281, 88 L.Ed. 333 (1944) ("It is not the theory but the impact of the rate order which counts."); *Jersey Central Power & Light Co. v. FERC*, 810 F.2d 1168, 1176 (D.C.Cir.1987) (en banc). Determining whether a taking has occurred in the ratemaking context requires us to examine whether the authorized rate reveals that the agency has reasonably balanced the investor and consumer interests at stake. *Jersey Central*, 810 F.2d at 1177-78. The "legitimate investor interest" is a question of

> the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating

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[4] Intervenor ACI objects that the Department's "comprehensive opportunity costs analysis," carried to its logical conclusion, could prevent airports from charging landing fees *at all*, depending on the level of benefit provided to the residents and businesses of the city-owner. But the Department has not in fact pursued that approach – to do so would raise a serious Takings Clause question.

> expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. [The return] should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

Id. at 1176 (quoting *Hope*, 320 U.S. at 603, 64 S.Ct. 281).

The Department contends, and we agree, that these principles do not precisely carry over to the situation presented here of a municipally-owned airport as the regulated entity. A municipality has no stockholders, so it makes little sense to analyze the proper return on equity. That is not to say that the Takings Clause has no application here. The Supreme Court has explained that the Clause applies to the federal government's condemnation of property owned by a local government, *see United States v. 50 Acres of Land*, 469 U.S. 24, 31, 105 S.Ct. 451, 83 L.Ed.2d 376 (1984), and we see no logical reason why a different rule should apply in the ratemaking context. Although the City (LAX) does not have equity investors, it does have bondholders, and it makes perfect sense to ask whether the entity's rates are sufficient "to maintain its credit" and to "assure confidence in the financial integrity of the enterprise." *Hope*, 320 U.S. at 603, 64 S.Ct. 281; *cf.* 49 U.S.C. § 47101(a)(13) (providing that it is the policy of the United States "that airports should be as self-sustaining as possible").

The only suggested "hardship" under the current fees is a lack of flexibility in undertaking airport improvement projects. (The thrust of the City's argument is the oblique claim that the City is being denied a "fair" rate of return.) The City has never alleged that its current

fees jeopardize the financial integrity of LAX, and therefore the City had no right to a hearing before the Department on its Takings Clause claim. *Compare Jersey Central*, 810 F.2d at 1181-82 (regulated entity was entitled to a hearing where it "presented allegations, which, if true, suggest that the rate order almost certainly does not meet the requirements of *Hope Natural Gas*, for the company has been shut off from long-term capital, is wholly dependent for short-term capital on a revolving credit arrangement that can be cancelled at any time, and has been unable to pay dividends for four years").

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For the foregoing reasons, the petition for review is *Denied*.

UNITED STATES OF AMERICA
DEPARTMENT OF TRANSPORTATION
OFFICE OF THE SECRETARY
WASHINGTON, D.C.

Issued by the Department of Transportation
on the 23rd day of December, 1997

LOS ANGELES INTERNATIONAL AIRPORT RATES PROCEEDING	Docket OST-97-2329 (Docket 50176)
SECOND LOS ANGELES INTERNATIONAL AIRPORT RATES PROCEEDING	Docket OST-95-474

FINAL DECISION ON REMAND

The Department of Transportation issued final decisions under 49 U.S.C. 47129 on the reasonableness of the landing fees charged at Los Angeles International Airport ("LAX") from July 1, 1993 through June 30, 1995, and from July 1, 1995 to the present. We determined that the fees were unreasonable insofar as they included a rental cost for the airfield and apron land based on the land's estimated fair market value. *Los Angeles International Airport Rates Proceeding* ("First LAX Rates Proceeding"), Order 95-6-36 (June 30, 1995); *Second Los Angeles International Airport Rates Proceeding* ("Second LAX Rates Proceeding"), Order 95-12-33 (December 22, 1995). On review the U.S. Court of Appeals for the District of Columbia Circuit remanded our decision in the *First LAX*

Rates Proceeding on that issue, although it affirmed our decision insofar as the airline complainants had challenged it. *City of Los Angeles Dept. of Airports v. Dept. of Transportation* ("*LAX I*"), 103 F.3d 1027 (D.C. Cir. 1997). The Court directed us to reexamine the City's arguments in favor of using fair market value for the airfield land in calculating the landing fees.

The Court's decision caused us to ask the Court to remand our decision on the land valuation issue in the *Second LAX Rates Proceeding*, since we based that decision on our rationale in the First LAX Rates Proceeding. *See* Order 95-12-33 at 17. The Court granted our request on March 7, 1997. *Air Transport Ass'n et al. v. Dept. of Transportation*, D.C. Cir. Nos. 96-1018 *et al.* ("*LAX II*") (March 7, 1997 order).

In response to the Court's remand, we asked the parties to submit briefs on the land valuation issue and tentatively determined to decide the issue on the basis of the existing record. Order 97-4-12 (April 10, 1997).

In their briefs the City of Los Angeles ("the City"), which owns and operates LAX, argues that its charge for the fair market value of the airfield land is reasonable, while the airline complainants argue that the charge is unreasonable. The Airports Council International – North America ("ACI"), an airport trade association that intervened in this case, supports the City's position. The parties agree that we should decide the issue without additional evidence.

After considering the briefs and the record in light of the Court's decision, we have determined that the airport's charge for the land's fair market value is unreasonable, as

explained in detail below. In summary, the issue is whether the City may include in the landing fee a rental charge for the airfield land based on the land's estimated fair market value, that is, whether the charge represents a cost that may reasonably be imposed on the airlines using the airfield. In concluding that this charge is unreasonable, we rely on several factors. Among other things, the charge cannot be justified as compensation for the airport's opportunity costs in using its land for airport facilities, since the City made a commitment to continue using LAX as an airport and the airport's overall revenues compensate the City for using the land as an airport. There is no economic policy reason for allowing the use of fair market value, because the City needs no additional incentive to use its property at LAX as an airport, for the airport provides significant economic benefits to the Los Angeles area. There is also no evidence that the fair market value charge is needed to deter excessive use of LAX. Finally, the use by every other U.S. airport of historic cost, not fair market value, in valuing its airfield assets for landing fee calculations further supports our decision.[1]

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[1] As indicated, our decision on the land valuation issue in the *Second LAX Rates Proceeding* relied on the findings in the *First LAX Rates Proceeding*, since none of the parties submitted additional evidence on that issue in the second case. Unless stated otherwise, all of the record citations in this order are citations to the evidence in the *First LAX Rates Proceeding*.

BACKGROUND

1. Regulatory Background

Like LAX, most airports used by commercial airlines are operated by a state or local government. Airports such as LAX charge airlines landing fees for using the airfield and different fees for using other airport facilities and services. Airport operations, like airline operations, have long been subject to extensive federal regulation. Federal law also authorizes airports to charge passenger facility charges ("PFC's").

Among other things, two federal statutes allow airports like LAX to charge airlines only reasonable landing fees. Section 511 of the Airport and Airway Improvement Act of 1982, now recodified as 49 U.S.C. 47107, which authorizes the airport grant program, requires airports that accept federal grant money for an airport improvement to give certain assurances to the Department. LAX, like most airports used by commercial airlines, has received substantial grants of federal funds for airport improvements.[2] One such assurance requires the airport to be available for public use on fair and reasonable terms and without unjust discrimination. This obligation to make the airport available on reasonable terms includes an obligation to charge aeronautical users only reasonable fees. *See* 61 Fed. Reg. 31994, 31995 (June 21, 1996).

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[2] From 1973 to 1993 the City entered into federal grant agreements enabling it to obtain $300 million in federal funds, and it had received over $175 million of these amounts by September 1993. Exhibit ATA-1. In the 1993-1994 fiscal year, the City's Department of Airports received $38 million in federal grants and $53 million from PFCs. Exhibit ATA-98 at 225.

Section 511 of the Airport and Airway Improvement Act of 1982 also provides, with some exceptions, that all revenues generated by a public airport, and any local taxes on aviation fuel, will be expended for the capital or operating costs of the airport, the local airport system, and other local facilities owned or operated by the airport that directly and substantially relate to the air transportation of passengers or property. As a result, under current law, LAX's revenues – whether derived from aeronautical or non-aeronautical users – may only be used for airport purposes and may not be diverted, for example, to the City's general fund.

The second statute allowing airports to charge only reasonable fees is section 1113(b) of the Federal Aviation Act, the Anti-Head Tax Act, recodified as 49 U.S.C. 40116. The statute allows publicly-owned airports to collect only reasonable rental charges, landing fees, and other service charges from aircraft operators for the use of airport facilities. *See Northwest Airlines v. County of Kent*, 510 U.S. 355 (1994) (*"Kent County"*).

Neither the airport grant statute nor the Anti-Head Tax Act restricts the airport fees charged non-aeronautical users, such as restaurants, stores, and parking lots.

To give airlines a more effective method for enforcing the airports' obligation to charge only reasonable fees, Congress enacted 49 U.S.C. 47129 in 1994. That statute requires us to decide whether a new or increased airport fee is reasonable in an expedited proceeding if an airline files a complaint against the fee and the complaint involves a significant dispute. *See First LAX Rates Proceeding*, Order 95-4-5 at 2-5. The statute, however, does not

change the substantive rights and duties of the airports or the airlines. *Id.* at 3, 12-13.[3]

While the statute requires us to determine whether a fee is reasonable and to award refunds to the extent that the fee is unreasonable, the statute also bars us from setting the fee. As a result, in cases decided under 49 U.S.C. 47129 we determine whether the airport's fee methodology and calculation are reasonable.

The new statute, 49 U.S.C. 47129, also required us to publish guidelines for determining whether a fee is reasonable. We first issued an interim policy statement on airport rates and charges, 60 Fed. Reg. 6909 (February 3, 1995) ("the Interim Policy Statement"), *petition for review dismissed, City of Los Angeles v. DOT,* D.C. Cir. Nos. 95-1188 *et al.* (July 1, 1996), and then a final policy statement on airport rates and charges, 61 Fed. Reg. 31994 (June 21, 1996) ("the Final Policy Statement"), *vacated in part, Air Transport Ass'n et al. v. Dept. of Transportation,* 119 F.3d 38 (D.C. Cir. 1997), *as modified on rehearing,* October 15, 1997 order. Both the interim and final policy statements required landing fees to be based on the historic cost, not the fair market value, of airfield assets. The Final Policy Statement allowed airports to use any reasonable

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[3] When Congress enacted 49 U.S.C. 47129, it also amended the airport grant statute's policy statement so that it states that airports "in establishing new fees, rates, and charges, and generating revenues from all sources, . . . should not seek to create revenue surpluses that exceed the amounts to be used for airport system purposes and for which airport revenues may be spent under 49 U.S.C. 47107(b)(1), including reasonable reserves and other funds to facilitate financing and cover contingencies." 49 U.S.C. 47101(a)(13).

methodology to set non-airfield fees. The Court of Appeals vacated the Final Policy Statement's provision allowing airports to use any reasonable method for setting non-airfield fees and vacated the historic cost requirement for airfield fees because the Final Policy Statement had not adequately justified the distinction between airfield and non-airfield fees. The Court's decision on the Final Policy Statement does not control this decision, since we have not based our decision on the LAX land valuation issue on the policy statements' guidelines. *See First LAX Rates Proceeding,* Order 95-6-36 at 19-26; *LAX I,* 103 F.2d at 1030, n. 1.

2. The First LAX Rate Proceeding

For many years the City used a residual fee methodology to calculate LAX's landing fees under an agreement with the airlines. Under that methodology, the airport's profits from non-airfield sources were used to reduce the airlines' landing fees. On the other hand, the airlines made a commitment to pay higher landing fees when needed to offset any losses on the airport's non-airfield activities. Because the airport's non-airfield revenues in recent years have exceeded its non-airfield costs, the airlines' fees for using the airfield in the last years of the residual fee system were significantly lower than the airport's airfield costs. *See First LAX Rates Proceeding,* Order 95-6-36 at 5. The residual fee agreement additionally gave the airlines an ability to veto major capital improvements at LAX. Exhibit LAX-C1 at 2.

In 1993 the airport switched to a compensatory methodology for calculating its landing fees. That methodology

based the fees on the airport's costs of providing airfield facilities and services. The airport's calculation of those costs included a charge reflecting the fair market value of the airfield land. *First LAX Rates Proceeding,* Order 95-6-36 at 19. The City originally bought the land at an average cost of $2,427 per acre and estimated the land's current fair market value at $150,000 per acre. The annual rental charge based on this estimated value was $14,861,900. *LAX I,* 103 F.3d at 1031.

After Congress enacted 49 U.S.C. 47129, sixteen airlines jointly filed a complaint alleging that the LAX landing fees charged since July 1, 1993, were unreasonable, in part because of the airport's inclusion of the charge representing the estimated fair market value for the airfield land. *First LAX Rates Proceeding,* Order 95-4-5 at 7. Our Order 95-4-5 set the airlines' complaints for hearing under 49 U.S.C. 47129.

The Department's Chief Administrative Law Judge, John J. Mathias, held a hearing and issued a recommended decision finding that the landing fees were unreasonable insofar as the City had used the airfield land's fair market value instead of the land's historic cost in calculating the fees. *See First LAX Rates Proceeding,* Order 95-6-36 at 19-20.

On review we affirmed his decision on this issue. In determining that the airfield land should be valued at historic cost, not fair market value, we relied on the use of historic cost by all other airports, the relative administrative ease of determining historic cost, and the airport's ability to recover its out-of-pocket costs by using historic cost. *First LAX Rates Proceeding,* Order 95-6-36 at 19-26.

The City and the airline complainants sought judicial review of our decision, which led to the Court's *LAX I* decision. While the court case was pending, we held a new proceeding under 49 U.S.C. 47129 on the reasonableness of new LAX fees, as discussed next.

3. The Second LAX Rates Proceeding

The City adopted higher landing fees at LAX for the fiscal year beginning July 1, 1995, just before we issued our final decision in the *First LAX Rates Proceeding*. The new fees also included a charge for the fair market value of the airfield land.

Fifty-nine airlines filed a complaint alleging that the new LAX landing fees were unreasonable. We issued a decision under *49 U.S.C. 47129* that found that the fees were unreasonable because, among other things, the airport had valued the airfield land at fair market value, not historic cost. We based our decision on the latter issue on the rationale and evidence used in the *First LAX Rates Proceeding*, since the parties had submitted no new evidence on this issue in the second proceeding. *Second LAX Rates Proceeding*, Order 95-12-33 at 17.

The City and the airline complainants sought judicial review of our decision. *Air Transport Ass'n et al. v. Dept. of Transportation*, D.C. Cir. Nos. 96-1018 (filed January 22, 1996) ("*LAX II*"). The Court stayed the proceedings in that case pending its decision on review of our decision in the *First LAX Rates Proceeding*.

4. The Court of Appeals' Remand

On review of our decision in the *First LAX Rates Proceeding*, the Court concluded that we had wrongly concluded that federal law prohibited the use of fair market value in calculating landing fees. In the Court's view we therefore had not given adequate consideration to the City's arguments defending its use of fair market value. *LAX I*, 103 F.3d at 1032. The Court remanded the land valuation issue to us so that we would consider the City's arguments.

The Court further questioned two elements of our rationale for disallowing the fair market value charge: our reliance on the universal practice of other airports of using historic cost for calculating landing fees, and our reliance on the relative difficulty of determining the fair market value of airfield land. 103 F.3d at 1033.

We did not seek rehearing or rehearing *en banc* of the Court's decision. We asked the Court to remand the land valuation issue in *LAX II* so that we could examine in a single proceeding the reasonableness of the airport's fair market value charge in the fees adopted in 1993 and those adopted in 1995.

5. Proceedings on Remand

To carry out the Court's remand order, we issued an order asking the parties to file briefs and reply briefs on the issue of the reasonableness of the airport's fair market value charge for the airfield land. Order 97-4-12 (April 9, 1997). The parties entitled to file briefs would be the airline complainants in each case that were eligible to

receive refunds (together with the Air Transport Association, an intervenor), the City, and ACI. *Id.* at 6.

We tentatively determined not to reopen the record in these cases, since our procedural rules for cases heard under 49 U.S.C. 47129 require parties in such cases to submit all of their evidence (subject to certain exceptions not relevant here) before we referred the case to an ALJ. *Id.* at 6-7.

We also ruled that we would reexamine only the land valuation issue – since the Court had remanded only that issue, our decisions on all other issues in the two LAX cases were final. *Id.* at 7.[4]

In their briefs the airline complainants continue to argue that the fair market value charge is unreasonable while the City and ACI contend that the charge is reasonable. In our analysis of our decision we will summarize the parties' positions on each of the issues.[5]

All of the parties agreed with our tentative decision that no new evidence should be introduced in this case and

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[4] We also extended our stay of the City's obligation to refund the portion of the landing fees representing the charge for the fair market value of the airfield land. Order 97-4-12 at 8. No one objects to that action. Due to that stay and the escrow agreement between the airport and the airlines, the airport has not yet had to repay the portion of the fees charged since 1993 that represent the fair market value charge, since there has been no final decision on whether the charge is reasonable. *See* Order 97-4-12 at 4, 8.

[5] The airline complainants and the City filed motions for leave to file unauthorized documents. We will grant these motions.

that we should decide the land valuation issue on the basis of the original record. Airlines Brief at 2, n. 1; LA Brief at 5, n. 3.

OUR DECISION

The question on remand is whether the landing fee calculation, based on a compensatory methodology, may reasonably include the charge for the fair market rental value of the airfield land. After considering the record in these cases on this issue and the points that the Court directed us to examine, we conclude again that the fair market value charge for the airfield land is unreasonable. Among other things, the City has no opportunity to use its LAX property for a non-airport use, so the City incurs no opportunity cost from using the property for an airport. The City needs no additional incentives to operate LAX as an airport, since the Los Angeles area obtains substantial economic benefits from the airport's operation. We also find that the historic cost requirement is consistent with the Constitution's prohibition against the taking of property without just compensation.

In explaining our decision, we will begin by discussing the airlines' statutory claims and the scope of our authority to review an airport's fee methodology under 49 U.S.C. 47129, and by explaining why Professor Arrow's declaration – a declaration originally submitted by the City and later withdrawn – is not properly within the record of this case. We will then address the City's principal justification for the fair market charge – its claim that the charge compensates the City for using LAX as an

airport. After explaining why we find that claim untenable, we will show that there is no other economic justification for the charge (for example, the City needs no additional incentive to use its property at LAX as an airport), and that the LAX charge is contrary to the practice of all other U.S. airports. We will then explain why the City's takings clause argument is without merit. Finally, while our decision in this proceeding would not be affected by the issue of whether calculating the fair market value of airfield land is substantially more burdensome than calculating the land's historic value, we discuss the record on this issue since our analysis may provide guidnace [sic] in future proceedings.

We have analyzed the reasonableness of the City's fair market value charge for the airfield land on the basis of the record in this proceeding, not on the basis of the Interim or Final Policy Statements. Our decision in this case does not foreshadow our eventual decision on airfield fee guidelines in our forthcoming proceeding for adopting such guidelines, a proceeding required by the Court's decision in *Air Transport Ass'n* partially vacating the Final Policy Statement. The airport parties are urging that those guidelines not require the use of historic cost for airfield fees. We will consider their proposals – and those of all other parties in that proceeding – on the basis of the record in that proceeding.[6]

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[6] As we stated earlier, we did not apply the Interim Policy Statement's historic cost requirement in our original decision on the LAX fair market value charge. In its brief the City argues that our determinations on reasonableness in the Final Policy Statement support its position, but this argument is based on a mischaracterization of the Final Policy Statement. On the

1. The Statutory and Regulatory Provisions on Allowable Costs

The Court remanded this case since it believed that we had wrongly read the statutes as prohibiting the use of the fair market value charge. The Court held that the applicable federal statutes do not exclude all costs but out-of-pocket costs from an airport's calculation of compensatory landing fees and that the statutes may allow an airport to recover such costs as opportunity costs. *LAX I*, 103 F.2d at 1032.

Notwithstanding the Court's decision, the airline complainants argue that the airport's fair market value charge is prohibited by the federal statutes, since those statutes assertedly require airport fees to be based on costs and since opportunity costs are not a legitimate cost within the meaning of these statutes. Congress allegedly intended to keep airports from making a profit from their aeronautical fees, including their landing fees. Airlines Brief at 3-9.

We agree with the airline complainants that Congress intended to limit airport fees and did not intend to give airports complete discretion over the level of their fees.

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ground that we recognized that fair market value can be a reasonable method of calculating non-airfield fees (but not airfield fees), the City wrongly claims that we are committed to allowing the use of fair market value for calculating airfield fees. LA Brief at 5. The City similarly errs in claiming that our decision in the policy statement rulemaking to allow imputed interest on some airfield investments means that we have effectively rejected our decisions in these cases to require LAX to value the airfield assets on the basis of historic cost. LA Brief at 6-7.

Congress, after all, included a reasonable fee requirement in both the Anti-Head Tax Act and the airport grant statute and created procedures in 49 U.S.C. 47129 for ensuring that airlines complaining about the reasonableness of a new or increased fee will obtain a hearing before an administrative law judge and a prompt decision in cases satisfying the jurisdictional requirements of that section. As we stated at the beginning of the *First LAX Rates Proceeding*, Congress created the expedited procedures required by 49 U.S.C. 47129 in the expectation that we would closely examine airport fees to ensure that they met the statutory standard. Order 95-4-5 at 26. But Congress' overall goal of limiting airport fees to reasonable amounts does not answer the question of whether the LAX fees are reasonable.

We cannot agree with the airlines' position that the fair market value charge is clearly barred by the terms of the statutes governing airport fees. The Court has already held that the applicable federal statutes do not prohibit the use of opportunity costs in calculating airport fees. Given the Court's ruling, we could not adopt the airline complainants' position in this case even if we agreed with it.

Instead of defining reasonableness by statute, Congress chose to give the Secretary the discretion to determine reasonableness. The statute requires the Secretary to adopt guidelines for use in determining whether airport fees are reasonable without limiting his discretion in choosing those guidelines, except by expressly giving airports the right to choose a compensatory or residual fee methodology or a hybrid of those methodologies. The statute's history confirms Congress' intent to give the

Secretary the authority to define reasonableness. *See, e.g.*, 140 Cong. Rec. S6986 (June 16, 1994) (Senator Feinstein); 140 Cong. Rec. S7030 (June 16, 1994) (Senator Boxer); 140 Cong. Rec. S6658 (June 9, 1994) (Senator Pressler). We therefore have the authority to determine whether an airport's fee methodology is reasonable or not, and that discretion applies to the issue remanded by the Court.

2. Our Authority to Review an Airport's Fees

ACI and the City contend that the Anti-Head Tax Act, the airport grant statute, and 49 U.S.C. 47129 require us to defer to the airport's judgment on the reasonableness of its fees, that we do not have the authority to set binding standards governing airport fees, and that an airport's fee methodology decisions are entitled to a presumption of validity. LA Brief at 13; LA Reply Brief at 11-12; ACI Brief at 2-4.

The airline complainants contend that the issue of the scope of our authority is an issue that we need not and should not consider here, since we had decided that issue in the earlier orders in the *First LAX Rates Proceeding*, the City did not seek review of our decision on that issue, and our decision therefore became final. Airlines Sur-Reply Brief.

We agree with the airline complainants' position. We held in the *First LAX Rates Proceeding* that Congress had intended us to examine in detail the reasonableness of an airport's fees, Order 95-4-5 at 26-27 and Order 95-6-36 at 15, and the City did not ask the Court to review that holding in *LAX I*.

The Court of Appeals, moreover, resolved this dispute over the scope of our authority in *Air Transport Association*, where it rejected the City's contention that we could not adopt reasonableness standards that would be binding on airports. *Air Transport Association*, 119 F.3d at 41. *See also New England Legal Foundation v. Massachusetts Port Authority*, 883 F.2d 157, 168-170 (1st Cir. 1989), affirming *Investigation into Massport's Landing Fees*, FAA Docket 13-88-2, Opinion and Order (December 22, 1988) at 8-9 (the First Circuit held that the Secretary had the responsibility and the expertise for administering the reasonable fee requirement in the airport grant statute).

Although the Court's opinion in *Air Transport Association* seems to suggest that the statutory reasonable fee requirements may require airport fees to be based on costs and require us to adopt precise standards for all fees charged aeronautical users, not just for airfield fees, 119 F.3d at 41, 43, the Court also suggests that we chose to submit fees "to something approaching de novo review" and thereby "seem[ed] to have burdened [ourselves] with administrative difficulties," 119 F.3d at 44, n. 7. The latter suggestion appears inconsistent with Congress' purpose in enacting the statute. As we have explained before in this proceeding, it is our view that Congress intended us to closely examine airport fees in cases heard under 49 U.S.C. 47129. *First LAX Rates Proceeding*, Order 95-4-5 at 26. Congress must have adopted the extraordinary procedures imposed by that statute, which include strict deadlines and a requirement to hold hearings before an administrative law judge on complaints satisfying the statute's jurisdictional requirements, with the expectation that we would resolve

disputes over airport fees without presuming that the airport's judgment was likely to be correct. Nothing in the terms or legislative history of the statute indicates that we should defer to an airport's judgment. The Court, moreover, gave no explanation for its suggestion that we should have chosen to construe the statute in a different manner. Even if the Court's suggestion represents a reasonable reading of the statute, our construction is certainly a permissible construction.

3. Burden of Proof

The airline complainants have the burden of proof in this proceeding, but, if they present a *prima facie* case that a fee is unreasonable, the burden shifts to the airport. *First LAX Rates Proceeding*, Order 95-6-36 at 17-18, citing the Administrative Procedure Act, 5 U.S.C. 556(d). The City contends that we must uphold the reasonableness of the fair market value charge because the airline complainants assertedly have failed to satisfy their burden of proof. LA Brief at 4-5. We disagree. The airline complainants have submitted evidence demonstrating that the charge is unreasonable, for example, evidence showing that no other U.S. airport calculates landing fees on the basis of fair market value.

4. Evidence within the Record

As noted above, all of the parties agreed with our tentative decision that the land valuation issue should be decided on the basis of the existing record and that no new evidence should be submitted in this proceeding. The only disagreement concerns the question of whether

the record includes the declaration of Professor Kenneth Arrow, a Nobel laureate in economics.

The City's response to the complaint filed in the *First LAX Rates Proceeding* included the declaration from Professor Arrow. In directing us to examine the City's economic arguments in favor of the charge, the Court of Appeals cited Professor Arrow's testimony. *LAX I*, 103 F.3d at 1034. The Court assumed that his declaration was part of the record in this proceeding, since the City had cited it in its brief (pages 8, n. 5, and 23). Neither our brief nor the airline complainants' brief had noted that his declaration was not properly part of the record.

In their brief in this remand proceeding, the airline complainants assert that Professor Arrow's declaration is not part of the record, since the City withdrew it before the hearing. Airlines Brief at 15. The City concedes that it withdrew his declaration before the hearing but argues nonetheless that we must consider it. LA Brief at 7, n. 9.

We agree with the airline complainants.

While the City's response to the airline complainants' amended complaint in the *First LAX Rates Proceeding* included Professor Arrow's declaration, the airline complainants objected before the hearing to his declaration. Complainants' Objections to Respondents' Exhibits (April 19, 1995) at 1. The City then agreed with the airline complainants that it would not submit Professor Arrow's declaration for purposes of the hearing. April 19, 1995 Letter from Steven Rosenthal to Allen Snyder (the City filed the letter in this docket). *See also* Respondents' Opposition and Response to Complainants' Objections to Respondents' Exhibits (April 21, 1995) at 2.

On the first day of the hearing, the Chief Judge therefore stated as to the airline complainants' objection to Professor Arrow's declaration, "[T]hat declaration has been withdrawn so the objections are moot." Tr. 25. Professor Arrow never appeared at the hearing, the City's final exhibits omitted his declaration, and the City's briefs to the Chief Judge and to us did not cite his declaration. Since the City withdrew the declaration and never made Professor Arrow available for cross-examination, his declaration is outside the record in this proceeding.

Despite this history, the City now argues that its initial filing of his declaration means that it is in the record before us. LA Reply Brief at 7, n. 9. The City's contention is plainly wrong. The evidence of record in a formal hearing case like this generally consists of the testimony and exhibits accepted at the hearing. A party's initial submission of a declaration (or an exhibit) does not make it part of the record if the testimony is not submitted at the hearing and the witness is not made available for cross-examination. *See, e.g.*, Tr. 12. Professor Arrow's declaration therefore cannot be part of the record.

We recognize that the Court's opinion cited Professor Arrow's declaration, but the Court did not rule that the record included the declaration and was not told that the City had withdrawn it. In these circumstances the Court's opinion cannot be construed as a ruling that we must treat Professor Arrow's declaration as part of the record. However, we would not find the airport's fair market value charge reasonable if his declaration were in the record, as explained below in our discussion of opportunity costs. In particular, he undertook no analysis of the

revenues and benefits obtained from using the LAX property as an airport before concluding that the City was incurring an opportunity cost by using the property for an airport.

5. The City's Opportunity Cost Argument

The Court remanded the case to us primarily so that we would consider the City's justification for its fair market value charge for the airfield land. The City's principal justification is its claim that the charge compensates the airport for its opportunity costs. Requiring the airport to use historic cost would allegedly deny the airport any compensation for its alleged opportunity costs incurred by using the land as an airfield. LA Brief at 5-11. According to the City, the fair market value charge "reflects the actual economic worth of the land and serves as a basis to calculate the opportunity costs associated with the use of the land." The City defines its opportunity cost as the value the City would have obtained from using the land in the best alternative use. LA Brief at 5.

In response the airline complainants argue that the airport is incurring no opportunity costs and that the fair market value charge is therefore unreasonable. Airlines Brief at 3-6.

We conclude that LAX incurs no opportunity cost when the airfield land is used for the airfield and that the charge cannot be upheld on that basis. The City has made a commitment to the FAA that it will continue operating LAX as an airport for a number of years to come. As a result of the City's agreement to continue using its LAX property as an airport, the City has no other opportunity

for use of the airfield land. Thus, whether or not opportunity costs are relevant in determining the reasonableness of airport landing fees, LAX's fair market value charge is unreasonable.[7]

The City has defined its opportunity cost as "the income forgone annually in order that the land be used as an airport. . . . " LA Brief at 5. Or, as the City stated in its reply brief, "LAX land is optimally employed as an airport if and only if it is at least earning the return it could receive in its best alternative employment (*i.e.*, its opportunity cost)." LA Reply Brief at 5. One of the City's economics experts, Professor Levy, similarly testified, "The opportunity cost of an asset or resource is its forgone value in its best alternative use." He reasoned that resources were optimally allocated "when the opportunity costs of their ownership is zero or negative; that is, when the present owner is deriving the maximum of all possible benefits from ownership." Exhibit LAX-F1 at 7.

When the City accepted federal grant funds for LAX, it gave the FAA the assurances required by the airport grant statute, 49 U.S.C. 47107. One of those assurances

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[7] Alternatively, if the City were deemed to have opportunity costs, its charge would still be unreasonable for two reasons. First, as explained below, the airport generates such large profits for the City's Department of Airports (and benefits for the Los Angeles area) that any opportunity costs are already covered by the airport's existing revenues from airfield and non-airfield sources. Secondly, it would be unreasonable for us to allow the City to charge for opportunity costs based on estimated earnings from non-airport usage when the City voluntarily agreed with the FAA that it would only use the property as an airport.

requires the grant recipient to continue operating the airport as an airport, 49 U.S.C. 47107(a)(1): "[T]he airport will be available for public use on reasonable conditions and without unjust discrimination." Another assurance requires the airport operator to maintain a current layout plan approved by the Secretary; it further bars the airport operator from making any change in the airport or any of its facilities if the change does not comply with the approved plan, if the Secretary decides that the change "may adversely affect the safety, utility, or efficiency of the airport." 49 U.S.C. 47107(a)(16).[8]

The City has accepted grant funds for LAX. In the eleven years ended September 1993, the City received more than $70 million in grants for LAX and had contracts with the FAA entitling LAX to additional grant funds. In every year during that eleven-year period the City signed at least one grant agreement for LAX. The most recent grant agreement was signed in September 1993 and authorized LAX to obtain up to $18 million in federal funds. Exhibit ATA-1 at 2-3; Exhibit ATA-71 at 3, 6. That agreement included a commitment that the City would operate LAX

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[8] The grant assurance requirements make up part of Congress' overall regulation of airport development and operations, regulation designed to create an efficient national air transportation system. Other grant assurances prohibit most airport operators, including the City, from diverting airport revenue to non-airport purposes. 49 U.S.C. 47107(b). Congress has similarly authorized airports like LAX to charge passenger facility fees for airport projects. 49 U.S.C. 40117. The City has imposed a passenger facility fee on travellers using LAX and obtained FAA approval for that fee on the condition that part of the fee revenues would be used for LAX airfield projects. *See Second LAX Rates Proceeding*, Order 95-12-33 at 36-41.

as an airport. *Id.* at 19, 25-26. The assurances would remain in effect for the life of the projects or twenty years, whichever is less. *Id.* at 20.

As a result, the City is legally required to continue using its property at LAX for airport purposes. This commitment means that the City has no opportunity to use the airfield land for any other purpose. The City therefore may not charge the airlines for its alleged opportunity costs when it has agreed to forgo the opportunity of using the property for any non-airport purpose. *See also* Tr. 429 (there is no opportunity cost, if the owner of land has no opportunity to change the use of the land).[9]

The City concedes that the assurances given by it as a condition to the federal grants require the City to maintain LAX as an airport, subject to certain exceptions. LA Brief at 8. The City nonetheless suggests that it has some ability to close LAX, an argument based on the closing of airports by other cities, LA Brief at 7-8, citing Denver's closing of Stapleton Airport when it opened Denver International Airport. The City, however, could close LAX only with FAA approval. The City has not shown that

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[9] In reviewing the Final Policy Statement's historic cost requirement for airfield fees, the Court noted that the Final Policy Statement had observed "that since airports are obliged to use their property as an airport, the concept of opportunity cost, and therefore fair market value, does not quite fit." *Air Transport Ass'n*, 119 F.3d at 44. And, if the City were viewed as having an opportunity cost, the City's commitment to continue using the land for an airfield would make it unreasonable for the City to charge airlines for revenues that it allegedly could obtain from non-airport use, since the City has agreed not to make any such use of the land.

there is any realistic possibility that the FAA would approve the closing of LAX. After all, the record indicates that LAX is the only practical site for an airport for Los Angeles. Denver, in contrast, could close Stapleton because it replaced it with a new airport, Denver International.

The City additionally notes that the grant conditions will not obligate it to operate LAX at its existing location "forever." LA Brief at 7-8. However, the grant conditions typically last for twenty years (and the City has cited nothing in the record indicating that its grant assurances will have a shorter term). Furthermore, the City began charging the fees at issue in this proceeding in 1993, and the City is currently obligated by its assurances to continue operating LAX as an airport.[10] Finally, nothing in the record indicates that the City is seriously thinking of abandoning LAX.[11]

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[10] According to the airline complainants, during the argument on review of the Final Policy Statement, the City's counsel implied that the restrictions on its use of the LAX land might end in about eight years. Airlines Reply Brief at 4, n. 4, citing *Air Transport Ass'n v. Dept. of Transportation*, D.C. Cir. Nos. 96-1253 (argued May 15, 1997). The Court's opinion seems to assume that the grant assurances either do not bind the City now or will soon become inapplicable. *Air Transport Ass'n*, 119 F.3d at 44. Any belief that the restrictions on the City's use of LAX have ended or will end within a few years would be wrong. The assurances created by the 1993 grant should in fact remain in force past 2010.

[11] In that regard we note that the City is developing a master plan for the airport that will enable LAX to accommodate the growth in passenger and cargo traffic expected during the next twenty years and is using its Internet website to promote the plan and seek comments on it. The City's

We find similarly unpersuasive the City's contention that someone may incur an opportunity cost after choosing to use a property or resource for a specific purpose and legally obligating itself to continue that use. LA Brief at 8-9. The City voluntarily chose to obligate itself to continue operating LAX as an airport. When it did so, it presumably concluded that using its property at LAX for the airport was the property's best use and that the benefits obtained from the airport amply covered the cost of using the LAX property for the airport. Furthermore, in return for the City's commitment, the City received large amounts of federal funds for the airport. We think that the City therefore could incur no opportunity cost, even if it were not otherwise compensated by using its LAX property as an airport. And in any event the federal grant funds received by the airport have compensated the City for maintaining LAX as an airport.

We are not persuaded, furthermore, that opportunity costs should be used in valuing airfield land in calculating landing fees. We are aware that, as the Court stated, a number of economists believe that regulatory agencies should use opportunity costs in setting rates or determining whether rates are reasonable. *See, e.g.*, William J. Baumol and J. Gregory Sidak, *Transmission Pricing and Stranded Costs in the Electric Power Industry* at 139 *et seq.*, cited at 103 F.3d at 1032. However, as the Court recognized, there are substantial benefits from using historic cost in ratemaking cases. Alfred E. Kahn, *The Economics of*

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development of the plan is consistent with the complete lack of record evidence supporting the City's claim that moving the airport would be a realistic possibility.

Regulation, vol. 1 at 41 ("[T]he transformation of the rate base by most state commissions from a hypothetical or imaginary to an actual book figure, representing actual money outlays, introduced a strong element of stability and predictability into the regulatory process"), cited at 103 F.3d at 1032. *See also Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Comm'n*, 262 U.S. 276, 292-308 (1923) (Brandeis, J., dissenting).

The Court of Appeals has recognized that regulatory agencies normally use historic costs for rate cases. *Jersey Central Power & Light Co. v. FERC*, 810 F.2d 1168, 1175 (D.C. Cir. 1987) (*en banc*) ("The Supreme Court cases of the 1940's eliminated the requirement that the market value of the property be recovered, and regulated industries now collect rates calculated to generate a reasonable return on the *original cost* of the investment") (emphasis in original). *See also* Exhibit ATA-D2 at 2. And, as shown below, no other U.S. airport has used the fair market value of land in setting landing fees.

Thus, as shown, while economists believe that historic cost has significant disadvantages when used in setting rates, regulatory agencies generally and airports almost universally continue to use historic cost in setting rates. We need not decide here, however, whether we would allow LAX to include opportunity costs in setting its landing fees, because the record demonstrates that LAX incurs no opportunity costs.[12]

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[12] The airline complainants contend that Professor Baumol and Mr. Sidak stated that opportunity costs should not be allowed in rates when the regulated firm has a monopoly and can charge monopoly prices. Airlines Brief at 12-13. This point

6. The City Needs No Additional Incentives To Operate LAX as an Airport

We see no other economic justification for the City's fair market value charge for the airfield land. As directed by the Court, 103 F.3d at 1034, we have considered the City's claim that the fair market value charge is necessary to give the City "the proper incentive" to continue operating the airport. We find that the City has not shown that it needs any such incentive. The airport provides major benefits for the Los Angeles area's economy, generates large earnings, and cannot practicably be replaced or moved, as shown next.

LAX's Economic Benefits for the City's Economy and Residents. The record indicates that using the LAX land for LAX is economically desirable since the Los Angeles area needs a major airport and has no other practicable location for a major airport.

As an important and dynamic city Los Angeles obviously must have an airport. Without an airport few travellers could easily reach the city, Angelenos could not conveniently travel to other cities, and Los Angeles could not

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seems irrelevant here, since our implementation of the reasonableness requirement for landing fees is intended to keep LAX from charging monopoly prices. The airline complainants also note that Professor Kahn argued that allowing regulated firms to charge prices based on factors like market prices creates the danger that the regulated firm will exaggerate its cost of service. Airlines Brief at 14. While this observation would be relevant in other cases to a decision on whether we should opportunity costs [sic] to be used in landing fee calculations, the City has failed to show here that it has incurred any opportunity costs.

be a significant commercial and industrial center or enjoy a substantial convention and tourist trade.

As demonstrated by the record, the airport greatly benefits Los Angeles. John Driscoll, the Executive Director of the City's Department of Airports, thus stated, "The Department fully recognizes the value of the Airport, the gateway to Southern California, as a tool of economic development for the community." Exhibit LAX-C1 at 4. One of the City's experts similarly testified that LAX was "an important economic asset of the City," that there was "no doubt" about that, and that without it the City "would not be what it is today." *Second LAX Rates Proceeding*, Tr. 379.

The record provides some evidence on the size of the benefits created by LAX. In 1994 the Los Angeles area had 25 million visitors who spent $7.2 billion, and almost seventy percent of all of its overnight visitors travelled by air. Exhibit ATA-98 at 117. And a memorandum prepared for the City stated, "The economic benefit of LAX to the Los Angeles area, however, may be quantified in terms of jobs (402,000); direct, indirect, and induced economic impacts ($37 billion per year); and state and local taxes ($1.7 billion per year), according to a 1992 study. . . . " Exhibit ATA-5 at 71, n. 34.

Secondly, no airport or combination of airports in the Los Angeles metropolitan area could substitute for LAX if the City were able to close LAX and use its land for non-airport purposes. The area contains other airports – Ontario, Hollywood-Burbank, Long Beach, and Orange County, but they are relatively small and could not handle the volume of passengers and cargo served by LAX.

In 1993, for example, seventy-three percent of the domestic passengers using an airport in that area used LAX, and virtually all of the international passengers using a Los Angeles area airport used LAX. None of the area's other airports served as much as ten percent of the area's total domestic passengers in that year. Exhibit ATA-98 at 103-104. LAX in fact was the world's fourth largest airport in 1993, based on total passengers. *Id.* at 120. *See also* Exhibit ATA-7 at 43, n. 45. Thus, in terms of the City's own economic interests, it could close LAX only if it could create a replacement airport of comparable size.

The record indicates, however, that LAX is the best possible location for a major airport for Los Angeles and that there is no good alternative site for an airport. The City's appraisal firm thus stated in their report, Exhibit LAX-14 at 20,

> [T]he relocation of the Los Angeles International Airport (LAX) is practically impossible. There are no urban sites in Los Angeles that can provide an alternative airport development site. In addition, the costs to acquire such a site would be prohibitive. Thus, from a financially feasible view, the current airport use of the site is the highest and best use. . . . In sum, based upon our research and analysis of the subject property, it is our opinion that the highest and best use of the subject property is the current airport use.

See also Exhibit ATA-48; Exhibit ATA-E2 at 5.[13]

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[13] The City has not cited any evidence indicating that the airport could be moved. The City's Department of Airports

The City's past conduct confirms that the City requires no additional incentives to use its land at LAX for the airport. Before the City switched to the compensatory fee methodology in 1993, it charged landing fees set under a residual fee methodology, which, as shown, ensured that the City would obtain no profits from the airport's operation. That did not deter the City from operating and expanding the airport. The airport had to offset its profits from non-airfield operations against its airfield costs in calculating its landing fees. The City nonetheless agreed to that restriction in order to ensure its ability to obtain the financing necessary for the airport's development and expansion. Exhibit LAX-C1 at 3. The City's willingness to forgo profits from airport operations indicates that the City believed that the airport's benefits to the City were great enough to amply justify LAX's operations even though the airport's aeronautical users did not pay fees covering their share of the airport's out-of-pocket costs under the residual fee agreement.

Furthermore, the City continues to operate three other airports – Ontario, Palmdale, and Van Nuys – although none of these airports seems to generate significant earnings. In the fiscal year ended June 30, 1994, for example,

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owns a large amount of land at Palmdale, but nothing in the record indicates that the City is considering using that land for an airport or that doing so would be practicable. We note, among other things, that Palmdale is farther from downtown Los Angeles than LAX and has limited highway access from Los Angeles. As noted earlier, the City is currently developing a master plan for expanding LAX's facilities, which indicates that the City recognizes that LAX is the only possible site for the area's major airport.

all three of those airports had an operating loss. Exhibit ATA-11 at 23.

LAX Produces Profits for the City. In addition, under the compensatory fee methodology the airport generates substantial profits for the City's Department of Airports, as we pointed out earlier in the *First LAX Rates Proceeding*, Order 95-6-36 at 22:

> The City's financial statements show that LAX has been quite profitable. For example, in the 1993-1994 fiscal year, the first year of the compensatory fees, the airport's net income from all operations was $71 million, and its operating revenues were almost forty percent greater than its operating expenses. The airport's landing fee revenues were $35 million higher in that year than in the previous year, the last year of the residual fees, but, even if the landing fee revenue had not increased, the airport's operating revenues would still have been twenty percent greater than its operating expenses. Exhibit ATA-11 at 23, 25.

The airport's operating earnings without the fair market value charge and net of the airport's $25 million interest expense, moreover, would still be $31 million, an amount that substantially exceeds the $15 million rental charge for the airfield land.

We have calculated these benefits on the basis of the airport's overall profits, not its earnings from airfield sources. Our analysis is consistent with the City's own definition of its incentives in terms of the overall airport. The City thus stated in its reply brief, "LAX land is optimally employed as an airport if and only if it is at

least earning the return it could receive in its best alternative employment (*i.e.*, its opportunity cost)." LA Reply Brief at 5.

Even if the City had not so stated the issue, we could consider the airport's overall earnings in assessing the reasonableness of the fair market value charge for the airfield land. The airfield services and the non-airfield services provided by the airport are joint products – the airport can obtain revenue from its non-airfield services only by providing the airfield services. The airport, after all, could not operate without runways and taxiways. Since the use of the airfield land for runways and taxiways is essential to the City's ability to obtain profits from other airport operations, any alleged revenue losses involved in that use of the land are amply compensated by the airport's overall earnings. Thus, while the profits derive from the airport's non-aeronautical activities, we may reasonably consider them in determining whether the City's use of the land for the airport imposes opportunity costs on the City.

The City's calculation of its alleged opportunity costs gave no recognition to the benefits it receives from the airport. The City's position essentially assumes that the City's use of the land as an airport creates no benefits at all for the City, a statement which, as shown, is contrary to the record and common sense. *See* Airlines Brief at 22; Airlines Reply Brief at 8-9.

The benefits provided the City and its economy by its operation of LAX undermine its opportunity cost claims. The City's expert, Professor Levy, stated that a person's use of a property incurs no opportunity costs if that use

generates more revenue than the person could obtain from any other use of the property: "the opportunity cost of an asset to its owner can be seen to be measured by the difference between the asset's market value or market stream of income and its value or stream of income to the owner." Exhibit LAX-F1 at 7. *See also Pennsylvania Electric Co. v. FERC, supra* (utility is not entitled to receive compensation for its alleged opportunity costs when its rates already compensate it for its costs of providing service). Thus, whatever opportunity costs are associated with the use of the land as an airfield are already covered by the airport's earnings.

The City wrongly argues that we may not consider the airport's value for the City as an offset to the City's claim for a charge equal to the fair market rental value of the land. According to the City, such a recognition of the airport's value would be contrary to the Supreme Court's decision in *Kent County* that federal law does not require an airport to use its earnings from non-aeronautical sources to lower its aeronautical fees. LA Brief at 9-10. This argument misconstrues our analysis and, as shown, ignores the City's own definition of opportunity costs. In considering the City's economic justification for the fair market value charge, we must determine whether the benefits currently obtained by the City for using the LAX property as an airport exceed the estimated amount of the land's fair rental value. Since we are not using the City's benefits to offset the City's other airfield costs, our analysis is consistent with the Court's holding in *Kent County*.

Similarly flawed is the City's contention that our consideration of the benefits provided by the City's use of the

LAX property for an airport would result in the airport being unable to charge any fees. LA Brief at 10. We are considering those benefits only to evaluate the City's arguments, as required by the Court, that the City incurs an opportunity cost and needs additional incentives to operate LAX. Our analysis in no way precludes the airport from charging landing fees covering its other costs. Indeed, we have upheld over the airline complainants' objections most of the other charges included in calculating the LAX landing fees.

7. The City's Claims of Overuse and Subsidization

Another economic justification for the fair market value charge offered by the City is its assertion that the charge is necessary to keep the airlines from making excessive use of the airfield. If the City cannot impose landing fees reflecting the true cost of providing airfield facilities and services, the airlines will assertedly overuse the airfield. Since the City assumes that the airfield's true costs include opportunity costs based on the fair market value of the land, which could otherwise be used for a different purpose, the City contends that disallowing the fair market value charge will cause airlines to make excessive use of the airfield. LA Brief at 12; Exhibit LAX-I1 at 4; Arrow Declaration at 4.

Nothing in the record indicates that the fair market value charge for the airfield land is needed to prevent overuse of the airfield or to correct a misallocation of resources. The City has presented no evidence that there has been excessive use of the airfield or that the higher fees are needed to prevent congestion. The City has also cited no

evidence suggesting that it adopted the fair market value charge in order to cause its facilities to be more efficiently used. In these circumstances the City has failed to justify the charge as a means of discouraging overuse of the airfield.[14]

We are similarly unpersuaded by the City's contention that we will be forcing the airport to subsidize the airlines' use of the airfield if we disallow the charge for the fair market value of the airfield land. LA Brief at 14. The airport would be subsidizing the airlines, however, only if the charge for the fair market value of the land reflected a cost borne by the airport. We do not believe there is any such a cost. As shown above, the City has failed to show that it incurs any opportunity costs by operating LAX as an airport. As a result, the landing fees, calculated under historic cost valuation, will cover the airport's costs of providing airfield facilities and services. We find, therefore, that the airport is not subsidizing the airlines.

8. Offset for Inflation

The City also contends that historic cost is an irrational cost standard to use since it does not account for general inflation. The City claims that the airport's cost of acquiring the airfield land should at least be adjusted to reflect

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[14] We have been willing to allow airports to charge fees that will encourage more efficient use of airport facilities. In particular the Final Policy Statement allows airports to charge peak-period prices when justified. 61 Fed. Reg. at 32016. The LAX landing fees do not include any peak-period charges.

inflation. The City's experts testified that general inflation was a factor that could be taken into account in valuing the land for purposes of the landing fee calculation. LA Brief at 12.

We recognize that economists consider that the valuation of an asset should reflect inflation, but we also know that regulatory agencies usually do not value assets at fair market value in ratemaking cases. But the fair market value charge – based only on the rise in land prices in the Los Angeles area – was never designed to offset general inflation and so cannot be justified on that basis.

Professor Ferdinand Levy, an economics expert for the City who helped develop the fee methodology, originally advised the City that his preferred methodology for valuing the land was "current cost," whereby the historic cost of the land would be adjusted by an increase based on the general rise in prices. Since the adjustment would reflect general inflation, not the increase in land values around the airport, he noted "a high probability that this method of valuation may not correspond closely to the market value of the land." Exhibit ATA-72 at 1, 6, 7.[15]

The airport's consulting firm rejected Professor Levy's recommendation on the ground that "we cannot identify an index capable of adequately adjusting historical costs

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[15] He further stated that the airport could obtain some compensation for the difference between the land's value determined under the current cost method and the land's actual value by increasing the rate of return allowed on the investment. Exhibit ATA-72 at 6. The City, however, chose not to include a rate of return in its fee calculation for its investment in the airfield land.

. . . to something remotely close to current value." Exhibit ATA-75. In other words, the airport's consultants rejected his proposal solely on the ground that it would not generate enough income, not on the ground of economic theory.

As a result, we cannot agree with the City that the fair market value charge should be upheld as compensation for inflation. The City did not create the charge as such compensation and chose not to adopt the one valuation method which would have fairly reflected inflation. We also note, as discussed in the next section, that no other airport has found it necessary to use the airfield land's fair market value in calculating landing fees, which suggests that the use of a cost standard that does not reflect inflation will not interfere with the airport's ability to operate and finance capital improvements.

9. The Universal Use of Historic Cost by U.S. Airports

Our earlier conclusion that the fair market value charge was unreasonable relied in part on the record evidence that LAX was the first U.S. airport to base landing fees on the fair market value of the airfield land rather than the land's historic cost. The Court, as noted, remanded our decision on the ground that we had not adequately considered the City's arguments, because we wrongly believed that federal law did not allow the airport to charge a fee based on the airfield land's fair market value. The Court, however, also questioned our reliance on the practices of other airports. The Court stated that we had said that LAX was the first airport to switch from

a residual fee methodology to a compensatory fee methodology. On that basis it considered our reliance on the practices of other airports unpersuasive. *LAX I*, 103 F.3d at 1033.

Our order asking the parties to file briefs in this remand proceeding pointed out that the Court had erred when it assumed that LAX was the first airport to adopt compensatory fees. In fact, many airports had begun using the compensatory fee methodology before the City, as shown by the City's own evidence. Order 97-4-12 at 8, citing Exhibit LAX-A1 at 4-5. Indeed the airport fees challenged in *Kent County* were compensatory fees.

In its brief in this remand proceeding the City contends that other airports assertedly had so little ability to use compensatory fees that their practices can provide no guidance, while ACI contends that the failure of other airports to follow a certain practice cannot mean that the practice is unreasonable. LA Brief at 20-23; ACI Brief at 5-6. The airline complainants, on the other hand, argue that the universal use of historic cost by other airports is relevant and should be followed by us in this case. Airlines Reply Brief at 6-7. Neither the City nor ACI tries to defend the Court's assumption that LAX was the first airport to switch to a compensatory fee methodology.

After considering the parties' arguments, we conclude again that the practices of other airports on the land valuation issue are both relevant to this issue and support our conclusion that the airport's fair market value charge is unreasonable.

We begin with the undisputed fact that no other U.S. airport calculates its landing fees on the basis of the fair

market value of its airfield land, as shown by the record. Tr. 643-644, 829-830. The City's consultant admitted that the City was the first airport in the United States to value its airfield land at fair market value. Tr. 646. *See also* Exhibit ATA-25 at 4.

We think the universal practice of other U.S. airports on valuing airfield land is entitled to considerable weight in determining whether the contrary practice adopted by LAX is reasonable. We view airport fee practices generally accepted by airports and airlines as a strong indication that they are widely considered reasonable by the industry, although, as noted by ACI, airport practices are not conclusive evidence on reasonableness issues. *Cf. Miami International Airport Rates Proceeding*, Order 97-3-26 (March 19, 1997) at 34-35, *petition for review pending sub nom. Air Canada v. Dept. of Transportation*, D.C. Cir. No. 97-1274. We have therefore taken airport practices into consideration in deciding other issues in these cases and used them as an indication of the types of fees and charges that are or are not considered reasonable. *Second LAX Rates Proceeding*, Order 95-12-33 at 33, 45; *First LAX Rates Proceeding*, Order 95-6-36 at 31. In addition, the use of a charge by only one of the many airports in the United States suggests that the charge is neither essential for airport operations nor generally viewed by other airports as desirable.

Our consideration of the practices of other airports is, of course, consistent with the Supreme Court's view on how the Secretary should exercise the authority to determine whether airport fees are reasonable. The Court thus stated in *Kent County*, 510 U.S. at 366-367:

> The Secretary of Transportation is charged with administering the federal aviation laws, including the [Anti-Head Tax Act]. His Department is equipped, as courts are not, to survey the field nationwide, and to regulate based on a full view of the relevant facts and circumstances.
>
> We conclude, therefore, that our consideration of the practices of other airports properly carries out our authority under the Anti-Head Tax Act to regulate airport fees.

We find unconvincing the City's arguments that the practices of other airports do not support the airlines' position that its fair market value charge is unreasonable. First, on the ground that many airports use fair market value in valuing the land under terminals and other non-airfield facilities, the City claims that airports in fact commonly use fair market value in setting aeronautical fees. LA Brief at 21. But while many airports use fair market value for setting non-airfield fees, as we have recognized elsewhere, no other airport uses fair market value for setting airfield fees. The airports' practice of using different methodologies for non-airfield and airfield fees, moreover, is based on the differences between the airlines' use of non-airfield and airfield facilities. 61 Fed. Reg. at 32007.

Equally unpersuasive is the City's contention that other airports have not set landing fees on the basis of fair market value since many airports used a residual fee methodology for calculating landing fees and thus were not in a position to even consider using fair market value. LA Brief at 21. This contention is inaccurate. As demonstrated by the City's own evidence, many airports had

adopted a compensatory fee methodology before LAX switched from residual fees to compensatory fees. *See, e.g.*, Exhibit LAX-A1 at 4-5.[16] The City further suggests that few of the airports cited in the 1984 report were using "a true compensatory methodology," LA Brief at 22, n. 20, but it gives no record citation for that assertion or any explanation of what a "true" compensatory methodology would be.

Similarly irrelevant is the City's observation that relatively few airports impose compensatory fees by ordinance, as LAX did, since most charge compensatory fees under agreements with the airlines, which would never accept airfield fees based on fair market value. LA Brief at 22, n. 20. Some airports, however, have adopted compensatory fees by ordinance. *See, e.g., Second LAX Rates Proceeding*, Order 95-12-33 at 45. Airports, moreover, generally have the right to adopt fees by ordinance, subject to any pre-existing agreements with airlines, so other airports could have used a fair market value charge if they had considered such a charge reasonable and desirable.

The City additionally asserts that we may rely on the practices of other airports in assessing the reasonableness of its fair market value charge only if we also take into

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[16] The City wrongly suggests that many airports could not consider using fair market value in calculating compensatory fees until the Supreme Court's *Kent County* decision rejected the airlines' argument that compensatory fees were unreasonable. LA Brief at 22. This assertion has no merit. Many airports – including LAX itself – were already using compensatory fees before the Supreme Court decided *Kent County*.

consideration the relatively low level of LAX landing fees compared to the fees charged by other major airports. LA Brief at 23. This argument has no merit. As we have said before, LAX's fees under a compensatory fee methodology must be based on LAX's costs. If LAX has relatively low costs, as it has, then it must charge lower fees. *First LAX Rates Proceeding*, Order 95-4-5 at 25. *See also* Exhibit ATA-77 at 2.

The City further errs in arguing that its fees are reasonable under Supreme Court precedent, whatever the merits of the individual elements of its fee methodology. The City cites Supreme Court decisions like *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944), which hold that a court reviewing a regulatory agency's rate decision should affirm the decision if the result is reasonable, even if the method is imperfect. LA Brief at 23. These cases govern judicial review of a regulatory agency's decision and do not hold or imply that a regulated firm's rate methodology is insulated from review by a regulatory agency.

10. The Airport's Compliance with the Self-Sustaining Requirement

The City contends that the fair market value charge is necessary to fulfill the City's obligation under a section of the airport grant statute, 49 U.S.C. 47107(a)(13), to charge fees "that will make the airport as self-sustaining as possible under the circumstances existing at the airport." LAX Brief at 18-19

We considered and rejected that argument earlier in this proceeding. We held that landing fees must be based on

costs and that the airport may not charge landing fees that will cause the airport to generate unreasonable surpluses. *First LAX Rates Proceeding*, Order 95-6-36 at 24. We reached the same conclusion in the policy statement rulemaking. 61 Fed. Reg. at 32010. The City has not shown any error in this reasoning.

11. Funding for Airport Capital Projects

ACI contends that we should give airports the option of charging landing fees based on the fair market value of airfield assets since airports must make substantial capital investments which they should be allowed to fund through higher fees. ACI Brief at 6-7. The City briefly notes that LAX has massive capital needs and that the airport could invest funds derived from charging for opportunity costs in its capital projects. LA Brief at 9. In response the airline complainants contend that the airport's alleged capital needs cannot justify the charge, for the airport may not now charge airlines for the cost of future capital improvements not yet completed and in use. Airlines Reply Brief at 2.[17]

We agree with the airline complainants. First, ACI's argument is inconsistent with judicial interpretations of the Anti-Head Tax Act. *City and County of Denver v. Continental Air Lines*, 712 F. Supp. 834 (D. Colo. 1989). Indeed, in the *Second LAX Rates Proceeding* the City agreed that the

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[17] The airline complainants additionally note that the City has been accused of diverting $90 million in airport funds, conduct which suggests that the City does not believe that the airport has insufficient funds for capital improvements. Airlines Reply Brief at 2, n. 2.

landing fees could not include costs associated with capital projects that were not yet in use. Order 95-12-33 at 49-51.

Secondly, we are unaware of any evidence in the record in this case indicating that the airport developed the fair market value charge in order to fund future capital projects. The record does show that one of the City's two goals for switching from a residual fee methodology to the compensatory fee methodology was to give the airport "greater control over the scope and timing of airport development projects." Exhibit ATA-23 at 6. LAX's residual fee methodology had given the airlines the power to veto major construction projects, as is common in residual fee agreements. The record does not indicate, however, that the City took into consideration airport capital needs in choosing the specific fee formula adopted by LAX and, in particular, creating the fair market value charge for the airfield land. In contrast, the record suggests that the airport instead may have adopted that formula in order to raise funds that could be diverted off the airport if federal law were changed to allow that diversion of airport revenues. *See, e.g.*, Exhibit ATA-4 at 4; Exhibit ATA-5 at 7. We are not deciding that the City adopted its fee methodology in order to raise funds available for diversion, but this evidence undermines any claim that the airport created the fair market value charge in order to fund airport improvements.

12. The Difficulty of Determining Fair Market Value

Our original decision disallowed the fair market value charge in part on the ground that calculating the fair

market value of airfield land would be significantly more difficult than calculating historic cost. Order 95-6-36 at 21. The ALJ similarly found that determining the fair market value of airfield land would be more difficult. R.D. at 16.

The Court questioned our reliance on this factor, since the Court doubted that the valuation of airfield land would be difficult. The Court assumed that there would be enough of a market in comparable land parcels to enable an appraiser to estimate the fair market value of the airfield land with some confidence. The Court reasoned that other regulatory agencies had stopped using fair market value because they typically dealt with assets such as utility plants that presented severe valuation difficulties. The Court noted, moreover, that the airline complainants in this proceeding had not challenged the City's estimated fair market value for the airfield land. The Court further assumed that the City would not recalculate the land's fair market value in future years, which would make the difficulty of valuing airfield land relatively unimportant. *LAX I*, 103 F.3d at 1033. In reviewing the Final Policy Statement the Court again expressed its doubt that resolving the value of airfield land would be difficult. *Air Transport Ass'n*, 119 F.3d at 44.

For the reasons discussed earlier in this opinion, we have determined that the City's fair market value charge is unreasonable. That determination essentially moots the issue of whether airfield land may be valued without undue difficulty. Moreover, as the Court pointed out, the airline complainants had not challenged the accuracy of the specific appraisal offered by the City in this case. Nonetheless, the question of the difficulty or lack of

difficulty in valuing airfield land is likely to arise in future cases, since we cited the relative difficulty of determining the fair market value of airfield land as a factor supporting the historic cost requirement for airfield fees in these cases and in the Final Policy Statement. *First LAX Rates Proceeding*, Order 96-6-36 at 21; 61 Fed. Reg. at 32010. The question of the difficulty of determining fair market value is, of course, important in airport rate cases, since the expedited procedures required by Congress in cases heard under 49 U.S.C. 47129 make the resolution of complex factual issues a severe burden. We will discuss the evidence in this case since it may help our analysis in future proceedings, even though the issue is not material for our decision in this case.

First, the record indicates that determining the historic cost of land is relatively simple. *See, e.g.*, Exhibit ATA-D2 at 2; Exhibit ATA-E1 at 6-7; Exhibit ATA-72 at 4 (the historical cost of an asset "is obviously quite easy to determine and to verify"). Determining the land's fair market value, on the other hand, is significantly more difficult. There is no easy objective method for determining the value of a large parcel of land like LAX's airfield.

Although the Court had assumed that airfield land could be appraised on the basis of comparable sales of land parcels, the appraisal firm used by the City determined that that approach should not be the primary basis for the appraisal. The firm instead based its fair market value estimate on "a hypothetical developmental approach." The firm stated that "meaningful analysis on a direct comparison basis is not possible" due to "the numerous differences in the development of such a large property

and the current environmental and political considerations." Exhibit LAX-14 at 21. For example, the appraisal firm noted that the owners of a 1,000 acre property just north of the airport had spent fifteen years trying to redevelop that property, formerly the Hughes Airfield, but had not succeeded due to "environmental and political roadblocks." Exhibit LAX-14 at 21. The appraisers indeed concluded that at that time – January 1, 1993 – the redevelopment of the airfield would not be feasible, since the market could not absorb more space and since financing for commercial/industrial projects was virtually nonexistent. *Id.* at 19. For these reasons, the firm did not rely primarily on comparable land sales and development projects.

For its appraisal the firm instead used "the estimated anticipated revenues which would be derived from the sale of finished commercial/industrial sites of a theoretical development over the projected term of the project." The calculation reflected estimated land development and construction costs, indirect costs, financing costs, and a profit for the developer. Exhibit LAX-14 at 21.

Thus, while the Court assumed that calculating the fair market value of the airfield land should not be difficult because "there is no need to reconstruct a hypothetical asset in order to account for technological changes, and there is often (indeed, perhaps usually) a ready market in parcels sufficiently comparable for a professional appraiser to extrapolate with some confidence," at least in this case the appraisal firm conducted an analysis that was similar to the creation of a hypothetical asset.

Of course, even if the appraisal had been based on sales of other land parcels, as the Court assumed would be possible, there could still be major disputes about the accuracy of the fair market value estimate. As the Chief Judge pointed out in the *First LAX Rates Proceeding*, when the estimate of fair market value is based on land adjoining the airport, the estimate uses land parcels whose value is greatly influenced by their location near the airport, which can lead to "bootstrap" accounting. R.D. at 16. If the estimate is based on land that is not near the airport, as was largely true of the estimate made by the City's appraisal firm, the validity of the estimate will depend on whether the land used for the calculation is comparable to the airfield land, an issue which may be difficult to resolve. *See also* Exhibit ATA-E1 at 6-7.

In suggesting that the difficulties of revaluing the land should have little significance in airport rate cases, the Court also believed that "there was no record evidence to suggest that the airport intended to recalculate its rate base periodically in order to capture increases in the market value of the underlying land; for all that appears in the record, however, the City would appraise the market value of the land only once, *i.e.*, for the purpose of bringing that land into the rate base." 103 F.3d at 1033.[18]

The record in fact suggests that the City was planning to revalue the land periodically. Exhibit ATA-74 at 1. Indeed, the logic of the City's preferred rate methodology calls

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[18] The Court did not explain the source of this belief. The parties' briefs had not addressed the point, and the record excerpts submitted to the Court did not discuss the matter.

for a periodic revaluation of the land. After all, the methodology assumes that the airfield fees will be inaccurate if they do not reflect the airfield land's fair market value. *See, e.g.*, Exhibit LAX-F1 at 16; Exhibit LAX-I1 at 2-3. Under this rate theory, the airport would have to revalue the land from time to time to ensure that the fee calculation used the correct value.[19] The airline complainants point out, moreover, that they should have the right to challenge a fair market value charge if the value of the land declines. Airlines Brief at 21-22.

The City's documents indicate that the airport had intended to periodically reexamine the land's fair market value. The City's consultants advised the executive director of the City's Department of Airports, Exhibit LAX-17 at 9:

> Having initially determined the appropriate return on airfield and apron land . . . , then re-determine an appropriate return on land every five years using a similar methodology. During the interim between formal re-determinations adjust land costs by an established economic index.

We note that the City's lease policy, as set forth in December 1986, similarly states that the property at each airport would be reappraised every five years. Exhibit LAX-31 at 4.

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[19] BAA, which operates airports in Britain and is the one airport operator identified in the record as basing its landing fees on fair market value, revalues its land annually. Exhibit LAX-D2 at 1-2.

The City has essentially conceded that the record indicates that the land would be periodically revalued. LA Brief at 20, n. 18. The City nonetheless contends that we should ignore the record evidence because the airport has not yet undertaken any such revaluation. *Ibid.* However, if, as the record suggests, the airport intended to revalue the land only every five years, the first revaluation would not occur until 1998. The lack of any revaluation so far is entirely consistent with the intent to periodically reexamine the land's market value.

The record in this case accordingly shows that determining the fair market value of an airport's airfield land in a contested fee case will be difficult and may well cause periodic disputes requiring resolution, given the likelihood that an airport using fair market value would periodically revalue its land. Given the time deadlines imposed by statute on our decision of airport fee cases under 49 U.S.C. 47129, the difficulty of determining fair market value for airfield land rationally suggests that landing fees should not use a fair market value charge.

13. The City's Takings Clause Argument

The City claims that it is entitled to a return on its investment in the airfield land under the Fifth Amendment's Takings Clause. The Takings Clause requires the government to pay fair compensation when it takes private property for public use. The Supreme Court has held that the Takings Clause applies when the federal government condemns property owned by a state or local government. *United States v. 50 Acres of Land*, 469 U.S. 24 (1984). While the Court has not held that the Takings

Clause applies to federal regulation of an activity carried out by a state or local government, we will assume here that the clause does apply to our regulation of airport fees.

The Takings Clause is generally viewed today as the source of the government's obligation to ensure that private utilities subject to rate regulation are allowed to charge rates that will give them the opportunity to earn a fair return on their investment. *See, e.g., Tenoco Oil Co. v. Dept. of Consumer Affairs,* 876 F.2d 1013, 1020-1021, 1022 (1st Cir. 1989), citing, *inter alia, Pennell v. City of San Jose,* 485 U.S. 1 (1988). The City assumes that the principles applicable to the regulation of rates charged by private utilities are fully applicable to landing fees charged by an airport owned by a state or local government. On that basis the City contends that LAX is entitled to a return on its investment in the airfield land. LA Brief at 23-25.

The issue in this remand proceeding is whether the airport may include the fair market value charge in the landing fee calculation or whether it must instead use historic costs in calculating the fees. The Supreme Court has held that a regulatory agency's use of historic cost valuation in rate-making cases does not violate the Constitutional principle that regulated firms must be allowed the opportunity to earn a return on their investment. *See Duquesne Light Co. v. Barasch,* 488 U.S. 299, 308-310 (1989). The Court's holding would seem to settle the issue. The City nonetheless argues that whenever the courts uphold rates based on historic cost the rates also provided for a return on the regulated firm's investment.

The airport, however, chose to include no return on investment in its fee methodology, except for an imputed interest charge for certain capital asset investments, a charge which we upheld. Although the City treats its fair market value charge as though it were the equivalent of a return on its investment, the City is not really seeking a return on its actual investment in the land, most of which was acquired many years ago. Instead, the City seeks to take advantage of the rise in land values in the area around the airport. *Second LAX Rates Proceeding*, Order 95-12-33 at 17-18. Indeed, as discussed above, the City's consulting firm rejected Professor Levy's preferred approach to valuing the airfield land – an approach based on the City's actual investment in the airfield adjusted for general inflation – because it would not enable the airport to charge fees comparable to the estimated fair market rental value of the land. And the City's brief in this remand proceeding admits that an imputed interest charge on its actual investment would be "a pittance" compared to the land's estimated fair market rental value. LA Brief at 6, n. 6. The landing fees thus were not intended to enable the airport to obtain a return on its investment. Furthermore, the rise in value of the airfield land in large part stems from the airport's success and the resulting growth of the City's economy and population.

Nonetheless, since the City has raised the Constitutional issue, we will address its argument that the Takings Clause gives the airport the right to charge landing fees that will enable the airport to earn a return on its investment in the airfield. After considering the standards used by the Supreme Court for determining whether a taking has occurred, we find that our decision here on airfield

fees does not constitute a taking of property without just compensation.[20] Our conclusion is based on an application of the Supreme Court's standards to airfield operations, so our conclusion does not cover non-airfield fees charged aeronautical users or fees charged non-aeronautical users. And our conclusion concerns fees that allow the airport to cover its out-of-pocket costs of providing airfield facilities and services, not fees that require the airport to charge less than those costs. Moreover, our analysis involves airports, which are different in important respects from typical governmentally-owned utilities, primarily because airports have long been subject to extensive federal regulation and have received large federal grants.

The City correctly points out that the courts have invariably held that private utilities have a right to an opportunity to earn a rate of return on their investment. The City is demanding that its operation of the LAX airfield be deemed the equivalent of a privately-owned firm's operations. Regulatory agencies must allow privately-

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[20] We reached the same conclusion in our original decisions and in our policy statement rulemaking. *First LAX Rates Proceeding*, Order 95-6-36 at 22; *Second LAX Rates Proceeding*, Order 95-12-33 at 17-18; 61 Fed. Reg. at 32011. The Court did not need to reach the Takings Clause issue in *LAX I*, because the Court remanded the case on other grounds. Since the City has used its Takings Clause claim to support the fair market value charge and since the City will presumably raise the Constitutional issue on review, we have chosen to discuss our reasons for finding that no taking has occurred.

owned firms to charge rates which give them an opportunity to earn a fair return on their investment. But this principle does not apply to a publicly-owned airfield.

The federal courts have never decided whether a publicly-owned utility like an airport is entitled under the Takings Clause to earn a profit. Given the differences between publicly-owned airports and private utilities, it would be irrational to blindly apply the principles governing private utility rates to airport rates, as the City seeks to do. In particular, as explained below, airports have not been built as profit-making enterprises, even though a number of airports like LAX earn profits from their non-airfield activities. We therefore think that the proper approach on this issue is to determine whether a taking has occurred under the general standards established by the Supreme Court for deciding whether a regulatory action constitutes a taking.

The Supreme Court considers three factors in determining whether government action constitutes a taking: the action's character, its economic impact, and the extent to which the action interferes with investment-backed expectations. *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 224-225 (1986); *Concrete Pipe & Products v. Construction Laborers Pension Trust*, 113 S. Ct. 2264, 2291 (1993). Under these standards requiring the airport to value the airfield land at its historic cost cannot be deemed a taking.

On the first factor, the character of our valuation requirement, there is no physical invasion or permanent appropriation of an airport's property. Instead, as is typical of many regulatory programs, our historic cost valuation

requirement adjusts the benefits and burdens of economic life in order to promote the common good. That type of regulation is not normally deemed a taking of property. *Connolly*, 475 U.S. at 225. That obviously does not end our inquiry, for regulatory decisions unreasonably limiting private utility rates can constitute a taking despite the lack of a physical invasion or permanent appropriation of the utility's assets and business. *See, e.g., Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989).

The second element of the Court's standard involves the economic impact of our decision. Requiring airport landing fees to be based on historic cost cannot have an unduly harmful impact on LAX. Even as limited by our decision, the airport's landing fees enable it to recover the out-of-pocket costs of its airfield investments and operations and to recover imputed interest on some capital investments. The airport may also include charges for reasonable reserve requirements and debt expense. Moreover, as shown, every airport in the United States except LAX has valued airfield land at historic cost in imposing fees. This indicates that a historic cost requirement does not conflict with an airport's ability to operate successfully. And since federal law does not limit the fees charged non-aeronautical users by LAX, the airport may – and does – charge fees for non-aeronautical facilities that make the airport's overall operations quite profitable.

The third element of the Court's standard concerns whether our decision has interferred with the City's investment expectations. *Cf. Connolly*, 475 U.S. at 226-227. We find for two reasons that there will be no such interference. *Cf. Connolly*, 475 U.S. at 226-227. First, state and

local governments invest in airports in order to further the well-being and general welfare of their citizens, not in order to make a profit. 61 Fed. Reg. at 32011. The City has cited no evidence in the record suggesting that the City's motives were any different when it created LAX. Indeed, for many years the airport used the residual fee methodology, which guaranteed that the airport would not earn significant profits, since the airport had to offset profits from non-airfield sources against its airfield costs in calculating landing fees. The City accepted that restriction on its ability to charge higher landing fees in order to obtain financing for capital developments. *See, e.g.*, Exhibit ATA-9 at 1-2; Exhibit LAX-C1 at 3. The City's willingness to accept the residual fee methodology supports our decision that the City did not build the airport with an eye towards earning profits from airport operations. The City, moreover, continues operating its other three airports, even though none of them appears to generate significant operating profits, as shown above. And the City's agreements with the airlines using Ontario limited the landing fees to the amount needed to cover operating and debt expenses and debt service and did not provide for any return on investment. Exhibit ATA-7 at 13-14.[21]

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[21] The California Supreme Court suggested that municipal water companies and similar types of municipal utilities in California historically included a rate of return element in setting rates. *Hansen v. City of San Buenaventura*, 233 Cal. Reptr. 22, 27 (Calif. 1986). Nothing in the record here indicates that airports in California ever followed that practice as to airfield fees. LAX, of course, did not when it operated under the residual fee methodology. An Illinois decision, moreover, suggests that a municipal utility serving its own residents is

Secondly, federal statutes have limited airport fees for many years and, as to airports like LAX that accepted federal grants, imposed other restrictions on the use of airport funds and property. In particular, the grant statute prohibits an airport owner (with a few grandfathered exceptions) from using airport revenues for non-airport purposes. As a result, the City could not transfer airport revenues to its general fund and could not have expected to earn any return on its investment in the airport. Nothing in the federal laws governing airports indicates that Congress expected that the state and local governments operating airports would derive earnings from airport operations and property. Public utilities, in contrast, expect to be able to pay out a substantial portion of their earning [sic] as dividends to their shareholders. Given these restrictions, a decision limiting the airport's landing fees to the amount needed to cover out-of-pocket costs, the funding of reserves, and imputed interest on certain investments cannot frustrate the City's investment expectations.

We also note that the City's claims assume that a privately-owned regulated firm is entitled to earn a return on all parts of its business. The contrary is the case. The courts have held that a rate decision may be Constitutional even though it causes the firm to operate part of its

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treated as acting in a governmental capacity and that rate of return considerations become relevant only when the municipal utility serves customers outside the city limits of the utility's owner. *Village of Niles v. City of Chicago*, 558 N.E. 2d 1331, 1335 (Ill. App. 1990). LAX's operations, of course, directly benefit the City's residents, even though many of its users are not Angelenos.

business at a loss. *Baltimore & Ohio Railroad v. United States*, 345 U.S. 146, 148 (1953); *Metropolitan Transportation Authority v. ICC*, 792 F.2d 287, 296-297 (2d Cir. 1986). Those decisions tend to support our decision here, although our decision will not force the City to operate any part of the airport at a loss. Any limitations imposed by us on LAX's airfield fees will not restrict the airport's non-aeronautical fees and fees for non-airfield facilities, and LAX earns large operating profits from its non-aeronautical revenues. And the airfield fees allowed by our decision will cover the airport's airfield costs as measured by the historic cost standard.

The City objects that the airport's earnings from non-airfield sources may not be considered in determining whether our decision disallowing the fair market value charge constitutes a taking. LA Brief at 24. In determining the reasonableness of a rate for an airport facility, we ordinarily may not offset the airport's earnings from other sources in determining whether the fee is reasonable. In this decision we made no such offset. But in determining whether the fee allowed by a regulatory agency is so low as to be confiscatory and a violation of the Takings Clause, the courts consider the total impact of the agency decision, which may involve a consideration of the regulated firm's earnings from related services.

Finally, we deny the City's claim that it is entitled to a hearing on a rate of return for the airfield fees. LA Brief at 25, n. 24. Requiring the landing fees to be based on historic cost does not violate the Takings Clause. Furthermore, the airport chose not to include a rate of return element in its fees, as shown above, except insofar as it charged imputed interest on a portion of its investment in

airfield capital assets. Since the airport decided to calculate its fees in a different manner and since our decision on the fees is consistent with Constitutional and statutory requirements, we see no need for us to hold a proceeding to revise the City's chosen methodology.

ACCORDINGLY:

1. We find that the landing fees charged by the respondents, the City of Los Angeles, the City of Los Angeles Department of Airports, and the Los Angeles Board of Airport Commissioners, for Los Angeles International Airport for the period from July 1, 1993, through June 30, 1995, and for the period from July 1, 1995, were unreasonable and therefore unlawful under 49 U.S.C. 40116, 49 U.S.C. 47107, and 49 U.S.C. 47129, insofar as the respondents include in the rate base for such fees a fair market rental based on an estimated fair market value for the land underlying the airport's airfield and apron;

2. We order the respondents, the City of Los Angeles, the City of Los Angeles Department of Airports, and the Los Angeles Board of Airport Commissioners, to refund with interest the fees paid from August 23, 1994, to the extent that such fees are unreasonable due to the inclusion in the rate base for such fees of a fair market rental based on an estimated fair market value for the land underlying the airport's airfield and apron, as provided by our earlier orders in the *Los Angeles International Airport Rates Proceeding* and the *Second Los Angeles International Airport Rates Proceeding;* and

3. We grant all motions for leave to file unauthorized documents.

By:

/s/ Patrick V. Murphy
PATRICK V. MURPHY
Deputy Assistant Secretary for
Aviation and International Affairs

(SEAL)

CITY OF LOS ANGELES DEPARTMENT OF AIRPORTS et al.,
Petitioners,

v.

UNITED STATES DEPARTMENT OF TRANSPORTATION et al.,
Respondents,

Aero California et al., Intervenors.

Nos. 95-1344, 95-1361, 95-1387, 95-1388 and 95-1422.

United States Court of Appeals
District of Columbia Circuit.

Argued Sept. 6, 1996.

Decided Jan. 17, 1997.

Steven S. Rosenthal, argued the cause, for petitioner City of Los Angeles, CA, with whom G. Brian Busey, Washington, DC, and Breton K. Lobner, Los Angeles, CA, were on the briefs.

William Karas, argued the cause, for petitioners Aero California et al., with whom Frank J. Costello, Jr., Washington, DC, was on the briefs.

Walter A. Smith, Jr., argued the cause, for petitioners Air Transport Association of America et al., with whom Allen R. Snyder, Jonathan L. Abram and Jonathan S. Franklin, Washington, DC, were on the briefs.

Thomas L. Ray, Attorney, U.S. Department of Transportation, argued the cause, for respondents, with whom

Anne K. Bingaman, Assistant Attorney General, U.S. Department of Justice, John J. Powers, III, and Marion L. Jetton, Attorneys, Nancy E. McFadden, General Counsel, U.S. Department of Transportation, and Paul M. Geier, Assistant General Counsel, were on the brief. Robert B. Nicholson, Attorney, Washington, DC, U.S. Department of Justice, entered an appearance.

Walter A. Smith, Jr., Allen R. Snyder, Jonathan L. Abram, Jonathan S. Franklin, Frank J. Costello, Jr. and William Karas, Washington, DC, were on the brief, for intervenors Air Transport Association of America et al.

Steven S. Rosenthal, G. Brian Busey, Washington, DC, and Breton K. Lobner, Los Angeles, CA, were on the brief, for intervenor City of Los Angeles Department of Airports.

Scott P. Lewis and Patricia A. Hahn, were on the brief, for intervenor Airports Council International – North America.

Janet P. Holt, Mark S. Kahan, Susan B. Jollie, Gary B. Garofalo, Moffett B. Roller, Washington, DC, Roxanne S. Clements, New York City, Stephen H. Lachter, Lawrence D. Wasko, Stephen L. Gelband and Joanne W. Young, Washington, DC entered appearances.

Before: EDWARDS, Chief Judge and WILLIAMS and GINSBURG, Circuit Judges.

Opinion for the Court filed by Circuit Judge GINSBURG.

GINSBURG, Circuit Judge:

The City of Los Angeles Department of Airports (hereinafter the City) and two groups of airlines request review, each for different reasons, of the order of the U.S. Department of Transportation approving in part the compensatory landing fee scheme that the City implemented in the spring of 1993. We grant the petition of the City and deny those of the airlines.

I. BACKGROUND

Until 1993 the City calculated the landing fee at Los Angeles International Airport (LAX) by subtracting estimated airport revenues from estimated airport expenses and dividing the remainder by the total estimated landed weight for the coming fiscal year. This so-called residual fee methodology produced landing fees that ranged from a low of $.26 per 1,000 pounds of landed weight in 1989 to a high of $.75 per 1,000 pounds of landed weight in 1982 and 1983. In 1992, the last year in which the City used this methodology, the fee was $.51 per 1,000 pounds of landed weight.

Anticipating the expiration of its fee agreements with the airlines, the City reevaluated its choice of the residual fee methodology. The City concluded that the practice of setting the annual landing fee so that total airport revenues would match total airport expenses resulted in a landing fee that was heavily subsidized by non-aeronautical airport revenues, such as parking contracts and concession franchising. In order to eliminate this subsidy and to increase the total revenues from LAX, the City decided to switch to a compensatory fee methodology when its residual fee agreements with the airlines expired

at the end of 1992. Under this new approach, landing fees would reflect the actual costs to the City of maintaining and operating the airfield and the apron.

Negotiations between the airlines and the City failed to produce a compensatory fee agreement. On June 28, 1994, therefore, the City unilaterally implemented a compensatory fee system. For accounting purposes, the airport was divided into five separate direct cost centers (the terminal, the apron, the airfield, aviation, and commercial) and four indirect cost centers (systems, general maintenance, general administration, and access). Aeronautical charges no longer reflected a credit for non-aeronautical revenues in excess of non-aeronautical costs. Instead, each airline effectively reimbursed the City for the actual costs of the services rendered to that airline in each airport cost center. In particular, the landing fee now reflected all direct costs the City incurred at the airfield and the apron cost centers plus the portion of airport indirect costs allocable to the airfield and the apron. As a result of this change, the landing fee at LAX rose to $1.56 from $0.51 per 1,000 pounds of landed weight. The City informed the airlines that they would not be permitted to land at LAX if they did not pay the increased fee.

Predictably, the City landed in court, where the airlines challenged the increased fee as unreasonable, in violation of the Anti-Head Tax Act of 1973, Pub.L. No. 93-44, § 7(a), 87 Stat. 90 (as amended, reenacted, and recodified at 49 U.S.C. § 40116); an undue burden upon interstate and foreign commerce; and a violation of the Chicago Convention, numerous Bilateral Air Service Agreements, and the "rights privileges and immunities secured to the [airlines] by the Constitution, treaties and

federal law." *Air Transport Ass'n v. City of Los Angeles*, 844 F. Supp. 550, 552 (C.D.Cal.1994). The district court granted the City's motion to dismiss the airlines' complaint for failure to state a claim upon which relief could be granted. The court held that under both the Anti-Head Tax Act and § 511 of the Airport and Airways Improvement Act of 1982, Pub.L. No. 97-248, tit. V, 96 Stat. 671 (as amended, reenacted, and recodified at 49 U.S.C. § 47107), it is the task of the Secretary of Transportation to determine in the first instance whether an increased airport fee is reasonable. *Id.* at 554-55.

Faced with the possibility of being deprived of their landing privileges if they persisted in not paying the increased fee, many of the airlines entered into a so-called "stand-still agreement" with the City in December 1993. The agreement, negotiated with the help of the Secretary of Transportation, provided that the airlines would pay the increased fee under protest and that the City would refund any portion of the fee that was eventually found unlawful. A lull in the fighting ensued.

On August 23, 1994 the Congress enacted § 113 of the Federal Aviation Administration Authorization Act, Pub.L. No. 103-305, 108 Stat. 1577 (codified at 49 U.S.C. § 47129). Section 113 creates an expedited administrative procedure for determining the reasonableness of airport fees and rates. An airline that wants to challenge a proposed fee increase must file a complaint no later than 60 days after receiving notice of the increase. § 113(a)(1)(B). The Secretary of Transportation then has 30 days within which to determine whether there is in fact "a significant dispute" as to the reasonableness of the fee increase. § 113(c)(2). If the Secretary finds that there is a significant

dispute, then he must assign the matter to an Administrative Law Judge, who is to issue a recommended decision within 60 days. § 113(c)(2) & (3). The matter then returns to the Secretary, who must render a final decision within 120 days of the filing of the complaint, failing which the ALJ's decision is deemed final. § 113(c)(4). In no event, therefore, should a significant dispute about the reasonableness of a fee increase remain unresolved for more than 180 days after the airport authority notifies the airlines of that increase.

The statute required the Secretary, within 90 days of its enactment, to publish regulations detailing the procedures "for acting upon any written request or complaint filed under subsection (a)(1)." § 113(b)(1). The Secretary was also required to publish in the same 90 day period substantive guidelines to be used "in determining . . . whether any airport fee is reasonable." § 113(b)(2).

On October 21, 1994 – less than 60 days after the Congress had enacted the statute and before the Secretary had published the procedural regulations required by § 113(b) – 16 airlines (since known as "the Original Complainants") filed a complaint under § 113(a)(1) challenging the compensatory landing fees they were paying to the City. On January 26, 1995 the Secretary accepted this complaint as timely filed, but informed the complainants that they should file an amended complaint no later than 30 days after the promulgation of the already overdue procedural rules and substantive guidelines for § 113. Those rules and guidelines were published in the Federal

Register on February 3, 1995.[1] On March 2 the Original Complainants duly filed an amended complaint under the new procedural rules.

On March 7, 1995 the Secretary issued a scheduling notice. In accordance with the procedural rule providing that "[i]f an air carrier . . . has previously filed a complaint with respect to the same airport fee or fees, any complaint by another carrier . . . shall be filed no later than 7 calendar days following the initial complaint," 14 CFR 302, 60 Fed. Reg. 6919, 6927, the scheduling notice provided that follow-on complaints must be filed by March 9.

Pursuant to the procedural timetable established in the scheduling notice, 37 airlines (known, not surprisingly, as "the Follow-on Complainants") filed complaints by March 9. Although the City objected that these complaints had not been filed within the 60-day limitation period established by § 113(a)(2), the Secretary

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[1] The City earlier challenged the substantive guidelines on the grounds that (1) the Department did not adequately explain the basis of the guidelines, in violation of the Administrative Procedure Act, and (2) they deny the City an adequate rate of return on its investment in aeronautical facilities, in violation of the Takings Clause of the Fifth Amendment to the Constitution of the United States. We dismissed this challenge as variously unripe and moot. See *City of Los Angeles v. D.O.T.*, Nos. 95-1188, 1996 WL 397488 (1996) (unpublished decision). Because the Secretary did not rely upon the guidelines when assessing the reasonableness of the airfield rental charge, and correctly held that the airlines failed to meet their burden of proof with respect to the other challenges here at issue, see Part II.C-D below, we need not pass today upon the applicability and validity of the guidelines.

announced that he would hear the complaints pursuant to his discretionary power under the Anti-Head Tax Act and § 511 of the Airport and Airways Improvement Act together with those that had been timely filed under § 113. The Secretary also determined that there was a significant dispute over whether the increased landing fee was reasonable and on April 3 ordered the ALJ to conduct a hearing into the compensatory fee system. The ALJ held hearings and announced his recommended decision in May 1995.

The Secretary announced his final decision at the end of June 1995. He found, and the various parties now dispute, that: (1) the City's inclusion in the rate base of a rental charge based upon the fair market value of the land underlying the airfield and the apron is prohibited by law; (2) the amortization charges that the City assessed the airlines with respect to various capital assets are reasonable; (3) the airlines failed to prove that the airport generated aeronautical revenues in excess of aeronautical costs by assigning a disproportionate share of the terminal costs to the airlines; and, (4) he was authorized to award relief only to those airlines that had filed complaints within 60 days of the enactment of § 113. This decision gave each party reason to complain and it is to their complaints that we now turn.

II. ANALYSIS

The City challenges the Secretary's determination that it may not lawfully charge a rent based in part upon the fair market value of the land underlying the airfield and the apron. The Original Complainants assert that the

amortization charges approved by the Secretary constitute double charging by the airport and that the Secretary mistakenly concluded that they failed to show that the airport has generated aeronautical revenues in excess of its aeronautical costs. Finally, the Follow-on Complainants contend that the Secretary's decision not to award them relief is based upon an unreasonable interpretation of § 113 and discriminates against foreign carriers in violation of various treaties governing international aviation.

A. Standard of Review

The Secretary's decision, if it is reasoned, is entitled to our deference. See *Northwest Airlines v. County of Kent*, 510 U.S. 355, 366-68, 114 S.Ct. 855, 863, 127 L.Ed.2d 183 (1994). The Secretary's findings of fact are conclusive if supported by substantial evidence, § 113(c)(6); and we will affirm his decision unless it is arbitrary and capricious, an abuse of discretion, or otherwise not in accordance with law. 5 U.S.C. § 706(2)(a).

The Supreme Court has long taught, however, that an administrative decision must not be affirmed if the agency failed to exercise the discretion entrusted to it by the Congress. *SEC v. Chenery*, 318 U.S. 80, 94-95, 63 S.Ct. 454, 462-63, 87 L.Ed. 626 (1943). More specifically, it is a well-established rule in this circuit that an agency must revisit its decision if it is "base[d] not on the agency's own judgment but on an erroneous view of the law." See *Prill v. NLRB*, 755 F.2d 941, 947 (D.C.Cir.1985); *IBEW v. NLRB*, 814 F.2d 697, 707-708 (D.C.Cir.1987).

B. Valuation of the Land Underlying the Airfield and the Apron

The City included among the airfield and apron costs a rental charge based upon the fair market value of the underlying land. The City bought most of this land at an average cost of $2,427 per acre. In calculating the rental charge, however, the City used the present fair market value of the land, which it estimated at $150,000 per acre. The resulting annual rental charge totaled $14,861,900.

The Secretary concluded that basing the rental charge upon the fair market value, rather than upon the historic cost, of the underlying land resulted in the airport recovering more than its "actual costs" and was therefore unlawful. The City argues that the Secretary based this decision upon a misunderstanding of the law.

The Secretary held that the Anti-Head Tax Act mandates the use of historic cost valuation to the exclusion of every other method of valuing land that is to be included in the landing fee rate base:

> Requiring an airport to base its landing fees on the historic cost of the airfield land will allow the airport to recover its actual costs. Allowing an airport to include an estimated fair market value for airfield land in the landing fee rate base will enable the airport to recover a surplus above its airfield costs, which would be contrary to law.

Final Decision at 20; *see also id.* at 24 (under Anti-Head Tax Act "airport fees [must] be justified by the airport's costs," which "mandat[es] the use of historic cost for airfield land"). Historic cost is, to be sure, one

permissible measure of costs in cost-of-service rate-making. The Secretary's view of historic cost as the apodictically indicated measure of "actual cost," is not, however, supported by the applicable law.

In *Smyth v. Ames* the Supreme Court first held that the "basis of all calculations as to the reasonableness of rates . . . must be the fair value of the property being used . . . for the convenience of the public." 169 U.S. 466, 546, 18 S.Ct. 418, 434, 42 L.Ed. 819 (1898). When it later overruled *Smyth*, however, the Court did not rule fair market value out of cost-of-service rate making; it held only that "the Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas." *FPC v. Natural Gas Pipeline*, 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037 (1942). Administrative convenience and the lack of precision introduced by a fluctuating rate base, the Court concluded, may justify the use of historic cost rather than current fair market value for the purpose of rate-making. *See Duquesne Power & Light v. Barasch*, 488 U.S. 299, 308-09, 109 S.Ct. 609, 615-16, 102 L.Ed.2d 646 (1989); *See also* I Alfred E. Kahn, *The Economics of Regulation* 41 (1970) ("[T]he transformation of the rate base by most state commissions from a hypothetical or imaginary to an actual book figure, representing actual money outlays, introduced a strong element of stability and predictability into the regulatory process").

Nor has the Court ever held that historic cost represents the only true measure of cost and the Secretary points to no law, regulation, or agency decision to that effect. On the contrary, agencies that regulate utility rates have recognized "opportunity cost" as a factor to be

considered when setting rates designed to cover the actual costs incurred to provide a particular service. *See, for example, Pennsylvania Elec. Co.*, 60 F.E.R.C. ¶ 61,034, 61,120 & n.1 (1992), *aff'd sub nom. Pennsylvania Elec. Co. v. FERC*, 11 F.3d 207 (D.C.Cir.1993) (opportunity cost relevant to Energy Policy Act requirement that rates "ensure that, to the extent practicable, costs incurred . . . are recovered"). Economists, too, have argued that opportunity costs should be considered in ratemaking. *See* William J. Baumol and J. Gregory Sidak, *Transmission Pricing and Stranded Costs in the Electric Power Industry* 139 *et seq.* (1995).

The Secretary was apparently of the view that an opportunity cost is not an "actual cost," in law or in economics, because it does not appear as a cash expenditure in the account books of the airport. Nothing in the Anti-Head Tax Act or § 113, however, prescribes an accounting rather than an economic conception of cost in airport ratemaking. We must, therefore, remand this aspect of the Secretary's decision for his fuller consideration of the respective merits of the historic cost and fair market value methodologies here at issue. *See Chenery*, 318 U.S. at 94-95, 63 S.Ct. at 462-63; *Prill*, 755 F.2d at 947; *IBEW v. NLRB*, 814 F.2d at 707-708.

As detailed below, the Secretary did make other findings in support of his conclusion that valuing the airfield land based upon any measure of cost other than historic cost would be "contrary to law." In light of the Secretary's fundamental misunderstanding of the governing law, however, we cannot afford those findings dispositive significance; for we cannot say that the Secretary would have drawn the same conclusion had he had only those

findings upon which to rely. Still, in order to avoid a useless round of litigation, we consider those other findings now in order to determine whether they would support the Secretary in adhering to his original decision on remand.

First, the Secretary observed that airports that use residual methodologies have also used historic cost. That the use of historic cost is reasonable under a residual fee regime does not, however, demonstrate that its use is uniquely indicated under a compensatory regime. LAX was, as the Secretary noted, the first airport to switch from a residual to a compensatory methodology. Not surprisingly, therefore, the Secretary had never before confronted the question of how properly to measure cost under a compensatory fee regime. The Secretary should confront this question directly on remand.

Second, the Secretary found that the use of fair market valuation could create practical difficulties not entailed by the use of historic cost valuation:

> [W]hen the estimate of fair market value is based on land adjoining the airport, the estimate uses land parcels whose value is greatly influenced by their location near the airport, which can lead to "bootstrap" accounting. If the estimate is based on land that is not near the airport, as the City claims was done in its estimate, the validity of the estimate will depend on whether the land used for the calculation is comparable to the airfield land, an issue which may be difficult to resolve.

Final Decision at 21. As the Secretary acknowledged, however, the airlines have never contested the accuracy

of the appraisal obtained by the City in this case. Nevertheless, the Secretary reasoned (*id.*) that:

> [A]llowing airport operators to use the airfield land's fair market value in a landing fee rate base will make it more difficult for us to assess the reasonableness of landing fees. The Supreme Court, moreover, has noted that regulatory agencies abandoned the use of fair market value as the means of valuing capital investments by public utilities due to the difficulties of calculating fair market value. *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 308-309, 109 S.Ct. 609, [615-16], 102 L.Ed.2d 646 (1989).

The difficulties to which the Supreme Court referred in *Duquesne* are not necessarily present in this or any particular airport case. Determining the present value of utility plant and equipment was especially difficult inasmuch as "a utility's assets, such as power plants, could not be set by a market price because such assets were rarely bought and sold." *Duquesne*, 488 U.S. at 309, n. 5, 109 S.Ct. at 616, n. 5. The process of valuing utility plant and equipment was further vexed by the necessity of taking into account any technological changes that may have occurred since it was built, and of doing so again and again in periodic ratemaking proceedings. As a result, the process "usually degenerated to proofs about how much it would cost to reconstruct the asset in question, a hopelessly hypothetical, complex, and inexact process." *Id.*, paraphrasing Justice Brandeis' dissent in *Missouri ex rel. Southwestern Bell Tel. Co. v. Public Service Commission*, 262 U.S. 276, 292-94, 43 S.Ct. 544, 548-49, 67 L.Ed. 981 (1923). Valuing land does not present the same difficulties: there is no need to reconstruct a hypothetical

asset in order to account for technological changes, and there is often (indeed, perhaps usually) a ready market in parcels sufficiently comparable for a professional appraiser to extrapolate with some confidence.

Moreover, the Secretary appears to have assumed, but there is no record evidence to suggest, that the airport intended to recalculate its rate base periodically in order to capture increases in the market value of the underlying land; for all that appears in the record, however, the City would appraise the market value of the land only once, *i.e.*, for the purpose of bringing that land into the rate base. To apply the lesson of *Duquesne* and its forebears to this case, therefore, without further explanation and analysis and without any inquiry into the relevant differences between the uses being made of fair market value in each context, was arbitrary and capricious.

On remand, the Secretary should give express consideration to the City's arguments in support of market valuation, which he did not address before presumably because he thought he was bound by the statute to use the historic cost approach. Specifically, the City argued, and presented the testimonial evidence of Professor Kenneth Arrow, a Nobel laureate in economics, to the effect that the methodology it adopted for LAX would cause the landing fees paid by the airlines to reflect the true cost of the airfield land; namely, "the value [the City] could have obtained in the best alternative use." See *Declaration of Kenneth J. Arrow*, ¶¶ 6-10 (March 13, 1995). This would, the City maintained, ensure that the actual costs of the airfield are borne by those receiving the benefits of the airfield and would create the proper incentive for the City to allocate land to airport use.

In sum, the Secretary was mistaken in his belief that the reference in § 113 to "actual costs" requires the use of historic cost in this case. We therefore remand the matter for his further consideration of the respective merits of the historic cost and fair market valuation methodologies in the present circumstances.

C. Amortization and Imputed Interest Charges

The costs attributed to the apron and airfield cost centers include amortization of certain capital assets acquired while the residual fee system was in use. The Original Complainants maintain that they are being charged twice for these assets: all the money collected under the residual fee system went into a single "pot" and the money used to pay for these assets must have come out of that pot. Therefore, so the argument goes, to charge the airlines for amortization would be to charge them again for assets that were bought in the first place with money that they supplied.

The Secretary determined that these amortization charges were properly assessed against the airlines because their purchase was never included as a line-item cost during the era of the residual fee:

> If a cost item was not included in the fee calculation during the period of residual fees, then the airport would not be getting paid twice if it included the cost in the rate base under the compensatory fee system. Thus, if the airport always treated the purchase as capital expenses which would be amortized over a period of time, then the cost of those assets was never included as an expense in the rate base under

> the residual fee system (except to the extent that part of the cost was amortized during that period), so that no airport user paid those costs.

Final Decision at 27.

The airlines challenge this determination, arguing that the cost of acquiring these assets was included as a line-item expense in the form of a "debt service charge." The airlines explain that in order to ensure that the interests of bondholders were adequately protected, the City of Los Angeles passed an ordinance that required LAX to generate total revenues that exceeded total costs by an amount equal to 25 percent of the airport's annual debt service. The charge, which ensured that this requirement was met, was included as an expense to be covered when setting the landing fee at LAX each year. The debt service charge was thus collected annually but, the airlines maintain, never actually used by the airport to service its debt. The airlines contend that these funds must, therefore, have been used to pay for any capital assets the airport purchased.

The airlines have pointed to a stream of revenue that the airport apparently collected each year under the *ancien régime*, but they have not linked this revenue to any corresponding expenditure for capital assets. Although the airlines have certainly shown that they were charged to provide a level of comfort to bondholders, they have not shown that they were charged for the capital assets for which they are now being charged amortization. The Secretary rightly concluded, therefore, that they have failed to meet their burden of proof.

The airlines also claim that the inclusion of imputed interest charges for airfield and apron improvements, facilities, and equipment violates the Policy Statement adopted by the Department in satisfaction of the requirement that the Secretary publish guidelines to be used "in determining . . . whether any airport fee is reasonable." § 113(b)(2). The Policy Statement strongly implies that an airport may not include in its rate base imputed interest charges with respect to an asset for which the airlines provided the purchase money. § 2.3.1, 60 Fed.Reg. at 6916.

Again, however, the Secretary concluded that the airlines simply did not carry their burden of proof with respect to the source of the funds used to acquire capital assets:

> [The complainants] are obliged to show that the funds used to purchase the assets came from aeronautical sources, which they have failed to do. In reviewing the record, we found no evidence that aeronautical sources provided the funds at issue.

Final Decision at 29.

We agree that the airlines failed to carry their burden of proof. The airlines do not even purport to identify any evidence in the record indicating that the funds used to purchase these assets were derived from aeronautical sources.

D. Aeronautical Revenues from Non-airfield Sources

The airlines maintain that the City attributed an excessive share of the terminal costs to them. Their point

is that the airport collected more from the airlines than it spent providing services to the airlines, whereas the Secretary had announced in the Policy Statement that both the Anti-Head Tax Act and § 511 of the Airport and Airway Improvement Act require that "revenues from aeronautical fees . . . not exceed the costs to the airport proprietor of providing airport services and facilities currently in aeronautical use." Policy Statement ¶ 2.1, 60 Fed.Reg. 6906, 6916 (February 3, 1995); *see also New England Legal Foundation v. Mass. Port. Auth.*, 883 F.2d 157 (1st Cir.1989). *Cf.* Proposed Policy Regarding Airport Rates and Charges, ¶ 2, 60 Fed.Reg. 47012, 47017 (September 8, 1995) (eliminating requirement that aeronautical revenues not exceed aeronautical costs).

Yet again the Secretary found that the airlines failed to carry their burden of proof. The expert witness for the airlines testified that terminal-related aeronautical revenues exceeded terminal-related aeronautical costs by $8.4 million, but the Secretary found this testimony unreliable. The expert admitted on cross-examination that he overestimated terminal-related aeronautical revenues by more than $5 million. Final Decision at 54. By reallocating access costs away from the airfield and terminal, the expert also underestimated aeronautical costs by at least $2.1 million. Finally, the expert's failure to base his own allocation of terminal costs upon any rigorous study infected his analysis with a degree of uncertainty that the Secretary reasonably found unacceptable:

> His assumption [that the terminal was split evenly between aeronautical and non-aeronautical uses] was not based upon any formal study. His calculated cost estimates, however, would

> change significantly if the amount of terminal space actually occupied by the airlines was a little larger than his fifty percent estimate. In fact, the expert admitted that his estimated revenue surplus would shrink by $1 million for each percentage point by which the airlines' share of the terminal space was greater than fifty percent. As a result, if the expert's estimate of aeronautical space was too low by eight percent, that would eliminate the entire aeronautical revenue surplus, even if his calculations contain no other errors. And the record indicated that the expert's estimate was almost certainly too low.

Final Decision at 35.

The airlines do nothing to blunt the Secretary's critique of their expert's testimony and offer no argument suggesting that the Secretary erred in concluding that they failed to meet their burden of proof. We therefore hold that the Secretary's decision upholding the City's allocation of terminal costs was not arbitrary and capricious.

E. Dismissal of the Follow-On Complaints

The Secretary concluded that he was not authorized to award the Follow-on Complainants relief under § 113 because they did not file their complaints within 60 days of the enactment of the statute. Final Decision at 58-60. The airlines argue that the Secretary's decision is "arbitrary, capricious, and contrary to the purpose of [§ 113]" because it does not afford each party that has been aggrieved by the fee increase at LAX a reasonable opportunity to file a complaint under § 113.

The Congress enacted § 113, creating the expedited procedure under which this action was heard by the Department of Transportation, on August 23, 1994. The statute makes this expedited procedure available only to an airline that files a written complaint within 60 days of receiving notice of a landing fee increase. § 113(a)(1).

As we have seen, the Original Complainants filed their complaint on October 21, 1994; the Secretary accepted that complaint on January 26, 1995 and instructed the airlines to file an amended complaint within 30 days of the promulgation of the procedural rules implementing § 113. Those rules were promulgated on February 3, 1995 and the Original Complainants filed an amended complaint on March 2, 1995.

The procedural rules provide that, while a follow-on complaint must be filed within seven days of the filing of an initial complaint, this seven-day period for filing a follow-on complaint does not extend the 60-day statutory period for filing any complaint. 60 Fed.Reg. 6919, 6927, 14 C.F.R. § 302.603(b) (in order to be considered under § 113, "all complaints . . . must be filed on or before the 60th day after the carrier receives written notice of the imposition of the new fee or the imposition of the increase in the fee"). Therefore, when the Department issued a scheduling notice on March 7, 1994 providing that "[c]omplaints by other carriers" were to be filed no later than seven calendar days after the Original Complainants had filed their amended complaint, it did not thereby extend the time for filing under § 113.

When, on March 9, 37 airlines filed follow-on complaints, and the Secretary accepted them even though

they were not filed within 60 days of the enactment of § 113, he did not suggest that he had the authority to grant retrospective relief to the Follow-on Complainants under § 113. See Instituting Order at 19, n.14. Rather, he accepted those complaints purely as a discretionary matter under the Anti-Head Tax Act and § 511 of the Airport and Airways Improvement Act, which authorize the Secretary to rule prospectively upon the reasonableness of an airport fee:

> We have the authority to adopt procedures for investigating the reasonableness of airport fees under our general authority to enforce the reasonableness requirement established by 49 U.S.C. 47107 and 49 U.S.C. 40116. . . . If we did not accept the follow-on complaints in this proceeding, those carriers would have the right to file a complaint with the FAA against the City under Part 13 of the FAA's rules. Such a result would be illogical.

Instituting Order at 20. In his Final Order of June 30, 1995 the Secretary reiterated that the Follow-on Complainants were entitled only to a prospective ruling upon the reasonableness of the fee increase at LAX. The Secretary explained that, although he had the discretion to hear the follow-on complaints together with the original complaints, he had the authority to award retrospective relief under § 113 only to those airlines that filed timely complaints; he could not "excuse carriers from complying with the statute's requirement that complaints be filed within sixty days." Final Decision at 59.

The Follow-on Complainants challenge the Secretary's determination principally on the ground that this is

an unreasonable interpretation of § 113 because it is not "fair to all concerned." The Follow-on Complainants are silent as to how precisely they would have had the Secretary interpret § 113. It appears, however, that by their lights an interpretation would be fair to all only if it afforded equal access to the expedited procedure of § 113 for the diligent and lax alike.

Be that as it may, we review the Secretary's interpretation pursuant to *Chevron, U.S.A. Inc. v. NRDC*, 467 U.S. 837, 842-844, 104 S.Ct. 2778, 2781-83, 81 L.Ed.2d 694 (1984). First, we must determine whether the Congress has spoken directly to the question of how § 113 applies to a complaint challenging a fee increase that was announced prior to the enactment of the statute. *Id.* If it has, then our inquiry is at an end "for the court, as well as the agency, must given [sic] effect to the unambiguously expressed intent of Congress." *Id.* at 842-43, 104 S.Ct. at 2781. If it has not, however, then the Congress has implicitly delegated interpretive authority to the agency, and the court must uphold the agency's interpretation if it is consistent with the statutory scheme. *Id* at 844, 104 S.Ct. at 2782-83.

Section 113(a)(1) provides that a carrier must file a "written complaint" challenging a fee increase under that statute "within 60 days after such carrier receives written notice of the establishment of or increase of such fee." At first glance, therefore, § 113 seems to bar the present action altogether because the Original Complainants did not (and could not, for § 113 did not then exist) file within 60 days of being notified of the proposed fee increase in late June of 1993. Upon closer inspection, however, we see that § 113(e)(3) states that the new

procedure may not be used to challenge an "existing fee not in dispute as of such date of enactment," which strongly suggests that an airline is permitted to file a complaint under the new procedure against a fee increase announced more than 60 days before the enactment of § 113 provided that the fee increase remained in dispute on the day of enactment. In any event, no party to this dispute maintains that the 60-day limitation period was intended to bar an airline from complaining under § 113 about a fee increase that was announced more than 60-days before the enactment of the Act.

It appears, moreover, that the Congress enacted § 113 in direct response to the dispute over the fee increase at LAX, *see, for example,* 139 Cong. Rec. H7573, H7578 (Oct. 7, 1993) (Remarks of Rep. Clinger), and that the Congress specifically intended that the airlines be able to use the newly-created procedure to challenge the LAX fee increase. *See, for example,* 140 Cong. Rec. S6988, S6988 (June 16, 1994) (Remarks of Sen. Feinstein, noting that "the airlines would be permitted to file a 120-day administrative proceeding with respect to" the fee increase at LAX and further remarking that the Act was amended with the specific purpose of ensuring that the "standstill agreement" between the airlines and the City would not be disturbed should the airlines file a complaint under § 113); *id.* (remarks of Senator Ford, describing Senator Feinstein's understanding as "complete and accurate").

The Secretary acknowledged the tension between the 60-day limitation period and the apparent intent of the Congress regarding this very dispute as follows:

> The statute expressly requires that complaints be filed within sixty days of the date that a carrier receives notice that the airport is increasing a fee or imposing a new fee. § 113(a)(1)(B). However, as shown, Congress clearly intended the statute to apply to the on-going dispute about the reasonableness of the LAX landing fees, even though those fees had been imposed well before the statute's enactment.

Final Decision at 59. In light of this tension, the Secretary concluded that the statute does not speak to the question of how it applies to a fee increase predating enactment of the statute and still in dispute on that date. We agree with the Secretary, as do the petitioners.

The disputed question is whether the Secretary's interpretation is "a permissible construction of the statute." *Chevron*, 467 U.S. at 843, 104 S.Ct. at 2782. Section 113 was enacted generally in order to provide an expedited procedure for challenging any increase in any airport landing fee in dispute then or in the future. The Congress intended specifically that the airlines be able to use this expedited procedure to challenge the 1993 landing fee increase at LAX. The Follow-on Complainants assert, therefore, that the Secretary failed to give effect to the intent of the Congress when he interpreted § 113 in a way that prevented them from using it to challenge the 1993 landing fee increase.

We think the Secretary adopted an interpretation of the statute that strikes a reasonable balance between two competing congressional aims. As he said at the time:

> To reconcile Congress' intent to allow the airlines to challenge the LAX fees under [§ 113]

> and the express requirement of a 60 day filing deadline for complaints, we construed the statute as requiring the filing of a complaint about the LAX fees within sixty days of the statute's enactment.

Final Decision at 59. We cannot say that the Secretary's reconciliation of these two congressional intentions is unreasonable or based upon an impermissible construction of the statutory scheme. We cannot say even that § 113(a) did not, in and of itself, provide adequate notice to the airlines of the need to file their complaints within 60-days of enactment of the statute. We therefore hold that the Secretary's interpretation of § 113(a)(1)(B) is a permissible response to the silence of the statute, and one to which we must presumptively defer.

Nonetheless, the Follow-on Complainants argue that the Secretary's interpretation should be afforded little deference because he did not announce his interpretation before issuing his Final Decision on June 30, 1995. They claim that they were led to believe that their complainants would be accepted when the Secretary announced that follow-on complaints should be submitted no later than March 9, 1995. They accuse the Secretary, in short, either of having changed his interpretation of § 113 at the end of the administrative proceeding or of having concealed from the outset, for some unknown reason, his true intention to deny the Follow-on Complainants a remedy.

But the Secretary was neither so fickle nor so foul. He consistently maintained that compliance with the 60-day limitation period is a *sine qua non* for receiving relief under § 113. The procedural rules are quite clear about

the force of the 60-day limitations period. 60 Fed.Reg. 6919, 6927, 14 C.F.R. § 302.603(b). The Secretary noted in his order accepting the original complaint that there was a dispute over whether the 60-day filing period "should be applied to begin on the date of enactment." Order 95-1-42, 4 (January 30, 1995). The Secretary accepted the original complaint under § 113 only because "the complainants filed a timely complaint by filing their initial complaint within 60 days of the statute's enactment." Order 95-4-5, 14 (April 3, 1995). At no point, moreover, did the Secretary suggest that he could accept or that he had accepted the follow-on complaints pursuant to his authority under § 113. Rather, the Secretary stated that he was accepting the follow-on complaints as an exercise of his discretion under 49 U.S.C. § 47107 and 49 U.S.C. § 40116. *Id.* at 19 & n. 14. Any suggestion that the Secretary somehow misled the Follow-on Complainants, or that he altered or first adopted his interpretation of § 113 only at the end of the administrative proceeding, is therefore unfounded.

The Follow-on Complainants also argue that the Secretary's interpretation of the 60-day limitation period constitutes a retroactive application of a substantive statutory provision that cuts off their right to a refund. The airlines here rely upon the Fifth Circuit's decision in *Hartford Casualty Insurance v. FDIC*, 21 F.3d 696 (1994), which involved a newly enacted statutory provision that cut off a pre-existing right. Section 113, in contrast, created a new statutory right conditioned upon meeting a set of newly adopted procedural requirements for filing a complaint. The Follow-on Complainants did not comply with these requirements. As a result, they never acquired

any rights that the Secretary's interpretation could cut off.

The Follow-on Complainants also challenge the Secretary's interpretation and application of § 113 on the ground that it discriminates against foreign carriers, in violation of various treaties requiring that foreign airlines receive national treatment. *See, for example, Convention on International Civil Aviation*, opened for signature Dec. 7, 1944, art. 15, 61 stat. 1180, 15 U.N.T.S. 295, T.I.A.S. No. 1591 (ratified by the United States on August 9, 1946) (providing that "every airport . . . which is open to public use by . . . national aircraft shall likewise . . . be open under uniform conditions to the aircraft of all other contracting States"). These treaties do forbid discrimination against foreign carriers, but the Secretary has done nothing to single out foreign carriers for discriminatory treatment. Every foreign carrier that filed a timely complaint, such as Varig Brazilian Airlines, received the same treatment as its domestic counterparts, while every untimely complaint, such as that of the domestic carrier Tower Air, was dismissed without regard to the national origin of the complaining airline.

Finally, the Follow-on Complainants maintain for the first time on appeal that the Secretary should have enforced the terms of the "standstill agreement" entered into between the airport and some of the airlines. That argument, however, is not properly before the Court because it was not raised before either the ALJ or the Secretary. See § 113(c)(6) ("No objection . . . shall be considered by the court unless [the] objection was urged before an administrative law judge or the Secretary").

III. CONCLUSION

The Secretary based his analysis of the valuation methodology adopted by the City upon the erroneous assumption that § 113 prohibits the City from including in the landing fee a rental charge reflecting the fair market value of the land underlying the airfield. As a result of this error, the Secretary did not give adequate consideration to the alternative fee methodology proposed by the airport.

The Original Complainants failed to show that the cost of acquiring the assets for which the City assessed them amortization charges had been paid by the airlines under the residual fee agreements in force prior to 1993. The airlines also failed to show that the airport was receiving terminal-related aeronautical revenues in excess of its terminal-related aeronautical costs.

Finally, we conclude that the Secretary permissibly determined that he had no authority under § 113 to award relief to the Follow-on Complainants, who did not file their complaints within 60 days of the enactment of § 113. The Secretary's interpretation of that provision was reasonable and the application of the 60-day limitation period to the Follow-on Complainants neither deprives them of a vested right nor constitutes discrimination against foreign carriers.

For the foregoing reasons we deny the petitions of the Original Complainants and of the Follow-on Complainants and grant the petition of the City. We remand

this matter for the Secretary to consider the City's proposed valuation methodology.

So ordered.

CITY OF LOS ANGELES,
et al., Petitioners,

v.

UNITED STATES DEPARTMENT OF TRANSPORTATION,
et al., Respondents.

Airports Council International – North America, et al., Intervenors.

No. 98-1071.

United States Court of Appeals,
District of Columbia Circuit.

June 18, 1999.

On Petitioners' and Intervenors' Petitions for Rehearing En Banc.

Before: EDWARDS, Chief Judge, WALD, SILBERMAN, WILLIAMS, GINSBURG, SENTELLE, HENDERSON, RANDOLPH, ROGERS, TATEL, and GARLAND, Circuit Judges.

PER CURIAM:

ORDER

The petitions for rehearing *en banc* of the City of Los Angeles, et al. and of the Airports Council International – North America and the response thereto have been circulated to the full court. The taking of a vote was requested. Thereafter, a majority of the judges of the court in regular active service did not vote in favor of either petition. Upon consideration of the foregoing, it is

ORDERED that the petitions be denied.

Separate statement filed by Circuit Judge SILBERMAN, concurring in the denial of rehearing en banc.

Separate statement filed by Circuit Judge WILLIAMS, with whom Circuit Judge GINSBURG joins, dissenting from the denial of rehearing en banc.

Chief Judge EDWARDS and Circuit Judges WALD and TATEL did not participate in this matter.

SILBERMAN, Circuit Judge, concurring in the denial of rehearing en banc:

The dissent seems to quarrel fundamentally with the sentence in the panel opinion that states, "In reviewing the Department's order, we do not sit as a panel of referees on a professional economics journal, but as a panel of generalist judges obliged to defer to a reasonable judgment by an agency acting pursuant to congressionally delegated authority." *City of Los Angeles v. DOT*, 165 F.3d 972, 977 (1999). It is apparently the dissent's view that we are authorized to review *de novo* the DOT's application of the concept of opportunity cost (as if economics were incorporated into, or somehow on an independent par with the Constitution). *Cf. Lochner v. New York*, 198 U.S. 45, 75, 25 S.Ct. 539, 49 L.Ed. 937 (1905) (Holmes, J., dissenting) ("The Fourteenth Amendment does not enact Mr. Herbert Spencer's Social Statics."). And if we think the Department insufficiently appreciated the virtue of opportunity cost pricing as a signaling device generating a more optimal allocation of society's resources, we are justified in rejecting the Department's decision as "erroneous." By contrast, the panel, although recognizing that

economists (or we) might disagree with the Department's rejection of opportunity cost pricing in this case, did not think that warranted us, as a reviewing court under a deferential standard of review, to object to the Department's decision. *City of Los Angeles*, 165 F.3d at 977.

Even assuming the issue should be thought as purely an economic one – which of course it is not (the issue might properly be described as whether LAX, having taken taxpayer money under the condition that it would continue to use LAX as an airport is legally entitled to charge a significant group of those taxpayers, airline passengers flying in and out of LAX, its opportunity cost based on a nonexistent opportunity) – petitioners did not produce testimony (or writings) of any economist to the effect that the market price of the airfield land should be considered as its opportunity cost under these circumstances.[1] Professor Arrow, who testified in the original proceeding as to the general appropriateness of opportunity cost pricing, *see Los Angeles Int'l Airport Rates Proceeding and Second Los Angeles Int'l Airport Rate Proceeding (Remand Decision)*, Order 97-12-31, at 11-12 (Dec. 23, 1997), never appeared in this remand proceeding, and, therefore, neither he nor any "non-resident" economist has expressed a view on the matter. Indeed, we ourselves had recognized that the scenario was more complicated than the typical opportunity cost setting in a prior opinion – which Judge Ginsburg joined (presumably pre-Econ

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[1] The dissenters' wish to assume away LAX's legal obligation reminds me of the old joke: How does an economist escape from a 25 foot hole? Answer: Assume a ladder.

101) – concerning DOT's rulemaking proceeding for airport fees. *See Air Transp. Ass'n of Am. v. DOT*, 119 F.3d 38, 44 (D.C.Cir.1997) ("[S]ince airports are obliged to use their property as an airport, the concept of opportunity cost, and therefore fair market value, does not quite fit.").

DOT alternatively assumed that if the grant condition were disregarded for purposes of opportunity cost analysis, the City – rather than just the airport – should be viewed as the relevant economic actor. The Department noted the enormous economic impact of LAX on the City: state and local tax revenues flowing from LAX were estimated at $1.7 billion in a 1992 study. Pursuing another opportunity on the LAX land would require forgoing this revenue or else building a new airport or expanding an existing minor airport like Burbank. Either option would be tremendously costly, and this cost should, in the DOT's view, be subtracted, in calculating the City's opportunity cost, from the profits to be earned in pursuing alternate uses of the LAX land. Perhaps an economist would treat the *airport* alone as the relevant economic actor. But again the City did not produce any economist's testimony in support of that proposition, so DOT's perspective was certainly reasonable. Judged from that viewpoint, the dissent's suggestion that if Los Angeles sold all of its LAX airport land to a real estate developer, airlines could simply fly into Burbank airport is about as realistic as Marie Antoinette's apocryphal advice to the hungry poor of Paris, "Let them eat cake."

* * *

Had this case turned on the quality of briefs and oral advocacy (as cases sometimes do), petitioners would

have won hands down. The Department of Transportation was represented, not by the excellent appellate lawyers from the Civil Division of the Justice Department, but by the General Counsel's office of DOT. Lawyers from the Antitrust Division of the Justice Department appear on the brief as of counsel. Insofar as that suggests Justice Department lawyers actually read and contributed to the briefs, I think the FTC should investigate for truth-in-labeling.

WILLIAMS, Circuit Judge, with whom Circuit Judge GINSBURG joins, dissenting from the denial of rehearing en banc.

The Department of Transportation ("DoT") regulates landing fees charged at Los Angeles International Airport ("LAX"). Here the panel decision upholds as reasonable DoT's insistence that the charge for the airport's land be calculated on the basis of historical accounting cost. 165 F.3d 972 (D.C.Cir.1999). Though there may be a good reason for the Department's conclusion, the two offered by the Department and approved by the panel appear erroneous.

As our earlier opinion made clear, the agency cannot reject opportunity cost – or any other reasoned proposal offered by a party – without some reason. See 103 F.3d 1027, 1031-34 (D.C.Cir.1997) (rejecting DoT's previous rejection of opportunity cost). The proposed use of opportunity cost is reasoned: it has the effect of giving the customers the correct signal as to the cost imposed on society by their use of the resource. See *id.* at 1034 (citing City's contention that opportunity cost pricing would "ensure that the actual costs of the airfield are borne by

those receiving the benefit"). In this case, giving that signal would be valuable because it would cause airlines to use correct figures in comparing LAX with alternatives available to them (e.g., Burbank). As the City argued here, pricing at less than opportunity cost can be expected to bring about excessive use of the airport. See Final Decision on Remand at 20.

The current panel opinion first embraces DoT's argument that the City obliged itself, in exchange for the statutory subsidy, not to divert the property from its use as an airport. Ergo, say DoT and the panel, there is no opportunity cost. This seems to rest on the idea that if some exogenous circumstance blocks application of a resource to other uses, it follows that use of opportunity cost is inappropriate. That is surely a non sequitur; the signalling referred to above is just as valuable as it would have been without the block. By contrast, of course, an inherent deficiency in the land (not alleged here) would properly cut down opportunity cost.

Suppose a person owns property in fee simple determinable, to hold "so long as the land is used as an airport." There plainly would be neither legal compulsion for him to price the airport's services at historic cost, nor would charges based on opportunity cost in any way logically contradict the terms of ownership. Thus the conclusion that use of historical cost was "a consequence of an unambiguously imposed condition," 165 F.3d at 978, appears to me a non sequitur.

The panel also accepts DoT's alternative idea that the economic benefits generated for the City by the airport "cover[ ]" the opportunity costs of the land. *Id.* at 976,

978-79. Of course the airport generates spillover benefits for the City.[1] But the panel never explains, and I cannot understand, why the existence of those benefits undercuts the reasons for using opportunity cost. They in no way reduce the utility of sending users accurate price signals.

Perhaps the point of this second theory is that reallocation of LAX to any other use would drive the City into depression, so that the apparent opportunity is a phantom. But that would be so only if we assumed that the airport would not be replaced, an absurd assumption. Further, even if the costs of replacing the airport would be higher than the opportunity cost of LAX, and so high that on net replacement elsewhere would be unwise, that would not logically undermine the proposition that the opportunity cost of *this land* is what its best alternative use would be. Even the foolish building of an extravagantly priced substitute airport would in fact release this land for alternative uses. Therefore, its value in those uses is its opportunity cost.

In reliance on these two theories, DoT concluded that "LAX incurs no opportunity cost." Final Decision on Remand at 16. Because of that belief, it refrained from resolving other possible theories supporting its rejection of opportunity cost. *See id.* (It mentioned the historic

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[1] It also generates spillover costs, such as noise pollution. And, as Intervenor Airports Council International – North America points out, many of the spillover benefits run to the airlines, for which the City creates a market; as the Intervenor observes, "Passengers do not choose air travel because they like the cuisine."

practice of airports to base charges on historic cost, see *id.* at 22-26, and various complications in computing opportunity cost, see *id.* at 26-29, but the decision does not suggest that these issues were decisive, and they played no role in the panel's affirmance.) As DoT has evidently rejected opportunity cost with no logically sound basis for doing so, another remand to DoT seems to me in order.

* * *

The engaging charm of Judge Silberman's rhetoric, ante, somewhat obscures his resolute refusal to engage the City's claim. That claim is simply that opportunity cost pricing tends to generate a more optimal allocation of business between suppliers of a good or service: here the service of enabling planes to land and take off, to receive and deliver passengers and freight, in the LA metropolitan area. The Department does not contest this proposition. It therefore does not require economists, resident or non-resident, Nobel laureates or fugitives from Econ 101, to assess its general truth. That is a given. Rather, the Department claims that the precept is inapplicable where (1) the owner of one source of supply has contractually obligated himself to use his assets for the specified purpose, or (2) the owner of the resource benefits in some collateral way from the business involved. As shown above, both those claims are simply non sequiturs.[2]

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[2] Notwithstanding the Concurring Statement at 2, they are not made any the less non sequiturs because a prior panel cited DoT's *contention* that LA's promise rendered the concept of opportunity cost inapplicable, a contention that the panel specifically cast doubt upon. See 119 F.3d 38, 44 (D.C.Cir.1997).

As for the fantasy of LAX being closed and entirely replaced by Burbank, that is a fantasy entirely of Judge Silberman's rich imagination – as any glance at the above text will show. It is not implicated by the simple thought that correct pricing of LAX's services would generate a better allocation of trade as between LAX, Burbank and any other (existing or as yet undeveloped) suppliers of the same service.

United States Court of Appeals

For The District of Columbia Circuit

No. 98-1071 **September Term, 1998**

City of Los Angeles, et al.,

Petitioners

v.

Department of Transportation, et al.,

Respondents

Airports Council International – North America, et al.,

Intervenors

BEFORE: Silberman, Sentelle and Randolph, Circuit Judges

ORDER

(Filed June 18, 1999)

Upon consideration of the petitions for rehearing of the City of Los Angeles, et al. and of the Airports Council International – North America, filed March 22, 1999, and of the response thereto, it is

ORDERED that the petitions be denied.

Per Curiam

FOR THE COURT:
Mark J. Langer, Clerk
BY: /s/ Robert A. Bonner
Robert A. Bonner
Deputy Clerk

AIR TRANSPORT ASSOCIATION OF AMERICA, Petitioner,

v.

DEPARTMENT OF TRANSPORTATION, et al., Respondents,

City of Los Angeles, Intervenor.

Nos. 96-1253, 96-1269.

United States Court of Appeals,
District of Columbia Circuit.

Argued May 15, 1997.

Decided Aug. 1, 1997.

Walter A. Smith, Jr., Washington, DC, argued the cause for petitioner Air Transport Association of America, with whom Allen R. Snyder, Jonathan L. Abram, Washington, DC, and Jonathan S. Franklin, Beverly Hills, CA, were on the briefs.

Steven S. Rosenthal argued the cause for petitioner City of Los Angeles, with whom Ronald N. Wilson, Stanley A. Zamel, Ardis M. Conant, Leilani F. Battiste, and Breton K. Lobner, Los Angeles, CA, were on the briefs. G. Brian Busey, Washington, DC, entered an appearance.

Thomas L. Ray, Attorney, United States Department of Transportation, Washington, DC, argued the cause for respondents, with whom Nancy E. McFadden, General Counsel, Washington, DC, and Paul M. Geier, Assistant General Counsel, Washington, DC, were on the brief. Marion L. Jetton and Robert B. Nicholson, Attorneys,

United States Department of Justice, Washington, DC, entered appearances.

Steven S. Rosenthal, Ronald N. Wilson, Stanley A. Zamel, Ardis M. Conant, Leilani F. Battiste, and Breton K. Lobner, Attorneys, City of Los Angeles Department of Airports, Los Angeles, CA, filed the brief for intervenor City of Los Angeles. G. Brian Busey, Washington, DC, entered an appearance.

Allen R. Snyder, Walter A. Smith, Jr., Jonathan L. Abram, Washington, DC, and Jonathan S. Franklin, Beverly Hills, CA, filed the brief for intervenor Air Transport Association of America.

Scott P. Lewis and Kenneth W. Salinger, Boston, MA, filed the brief for amici curiae Airports Council International-North America and American Association of Airport Executives. Patricia A. Hahn entered an appearance.

Before: SILBERMAN, GINSBURG, and HENDERSON, Circuit Judges.

Opinion for the Court filed by Circuit Judge SILBERMAN.

SILBERMAN, Circuit Judge:

Petitioners City of Los Angeles and the Air Transport Association of America, an airline trade association, each challenge the Department of Transportation's Final Policy Regarding Airport Rates and Charges. We grant the petitions for review and remand.

I.

Airports are required by statute to charge aeronautical users reasonable fees.[1] Section 511 of the Airports and Airways Improvements Act, codified at 49 U.S.C. § 47107 (1994), requires an airport that accepts federal grant money (or land) to assure that the airport will be available for public use on reasonable conditions and without unjust discrimination; this assurance has been interpreted to include a requirement that the airport's fees be reasonable. *See New England Legal Found. v. Massachusetts Port Auth.*, 883 F.2d 157, 169-70 (1st Cir.1989). Similarly, the Anti-Head Tax Act allows a publicly owned airport to collect only reasonable landing fees and charges from aeronautical users. *See* 49 U.S.C. § 40116(e)(2) (1994); *Northwest Airlines v. County of Kent*, 510 U.S. 355, 366, 114 S.Ct. 855, 862-63, 127 L.Ed.2d 183 (1994). Although the Department of Transportation (DOT) has adjudicated disputes over the reasonableness of airport fees under these statutes, *see, e.g., New England Legal Found.*, 883 F.2d at 163-66, until recently it never promulgated regulations defining what it thought to be reasonable airport fees. Airlines and airports did, however, take these issues to court. *See, e.g., Northwest Airlines*, 510 U.S. 355, 114 S.Ct. 855; *New England Legal Found.*, 883 F.2d 157; *Indianapolis Airport Auth. v. American Airlines*, 733 F.2d 1262 (7th Cir.1984), *disapproved by Northwest Airlines*.

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[1] Airports collect the bulk of their revenues from two general groups of users: aeronautical users, such as commercial (passenger) airlines, and non-aeronautical concessionaires, including car rental agencies, parking lots, restaurants, gift shops, and other small vendors.

In August 1994, Congress enacted § 113 of the Federal Aviation Administration Authorization Act, codified at 49 U.S.C. § 47129 (1994), which required the Secretary of Transportation to publish "final regulations, policy statements, or guidelines establishing – . . . the standards or guidelines that shall be used by the Secretary in determining under this section whether an airport fee is reasonable." *Id.* § 47129(b)(2). That section also created an expedited administrative procedure in which an airline may challenge before the Secretary the reasonableness of an airport fee. *See City of Los Angeles Dep't of Airports v. Department of Transp.*, 103 F.3d 1027, 1030 (D.C.Cir.1997) (*LAX I*). In such proceedings, only the reasonableness of the challenged fee is open to question; the Secretary "shall not set the level of the fee." 49 U.S.C. § 47129(a)(3).[2]

The Secretary adopted an "Interim Policy" in February 1995 which required that aeronautical fees be capped by the cost to airports of providing aeronautical facilities and services. The interim policy also required that airfield assets be valued at their historic cost in determining the total costs that could be recovered from fees. Airports complained that the Interim Policy would force them to change their operating methods and would damage their ability to finance improvements, since they had commonly based fees for certain aeronautical facilities (such as terminals) on something other than historic cost.

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[2] Section 113 permits airports to choose either a residual fee methodology, a compensatory fee methodology, or any combination of the two. *Id.* § 47129(a)(2).

In June 1996, after receiving comments on a "Supplemental Proposed Policy," the Secretary published a regulation entitled the "Final Policy Regarding Airport Rates and Charges." The Final Policy, unlike the Interim Policy, distinguishes between airfield and non-airfield fees. For airfield fees – aeronautical fees charged for the use of the runways, taxiways, ramps, aprons, and roadway land – the Final Policy maintains the Interim Policy's requirements that aeronautical fees be capped at actual cost to the airport, and that airfield assets be valued according to their historic cost. For non-airfield fees – aeronautical fees charged for the use of all other aeronautical facilities and services, including terminals, hangars, cargo space, and maintenance – the Final Policy instead permits airports to use "any reasonable methodology."

According to the Secretary, requiring that assets be valued at historic cost in setting airfield fees is consistent with current practice, permits airports to recover their out-of-pocket costs, and, since historic cost is easily determined from accounting records, will help avoid controversies and be easier to administer. The Secretary rejected fair market valuation as a methodology for valuing assets in determining airfield fees because the Secretary thought that airports do not have "opportunity costs" in airfield assets since they are committed to continued operations. The Secretary also thought that the Final Policy's treatment of non-airfield fees is consistent with past practice (which had not resulted in disputes), and would permit pricing to reflect the differences among non-airfield facilities. The Secretary believed it unlikely that airports can or will exercise market power in setting non-airfield fees.

The Final Policy also permits airports to include in airfield fees a charge for imputed interest on those aeronautical funds reinvested in the airfield, *unless* the invested funds derive from airfield fees. A charge for imputed interest, according to the Secretary, lets airports recover their opportunity costs in the airfield (if any) and compensates for inflation. But imputed interest cannot be charged for airfield revenues reinvested in the airfield because the Secretary believes airfield users might then be financing airfield investment twice: once in the form of otherwise reasonable airfield fees that turned out to generate excess revenue, and once on the imputed interest charge on the investments made with that revenue.

Petitioners attack the Final Policy from both sides. The Air Transport Association of America (ATA), on behalf of its members, challenges what it sees as the Final Policy's complete deregulation of non-airfield fees. The City of Los Angeles challenges the Final Policy's requirement of historic cost for airfield fees.

II.

Anterior analytically to the main dispute between the two petitioners and the Secretary – whether the regulation's[3] disparate treatment of airfield and non-airfield fees is arbitrary and capricious under the Administrative Procedure Act (APA) – is the nature of the Secretary's authority and obligation to issue regulations (guidelines) which set forth a particular methodology for determining

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[3] Although he calls it a Final "Policy," the Secretary has clearly promulgated a rule.

the reasonableness of fees. Los Angeles contends the Secretary has no such power, whereas ATA claims that not only does he have that authority, he must use it in a meaningful manner for both airfield and non-airfield fees.

Los Angeles argues that the statute obliges the Secretary to take a relatively passive role: he "may only determine whether [a] fee is reasonable or unreasonable and shall not set the level of the fee." 49 U.S.C. § 47129(a)(3). Emphasizing the differences that exist among airports regarding airfield and non-airfield facilities and financial structures, it contends that Congress, understanding those differences, intended that the Secretary's role be limited to determining whether a particular airport's fees meet an overall (bottom line) reasonableness standard. *Cf. Federal Power Comm'n v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037 (1942). Each airport is therefore entitled to use *any* reasonable methodology, and the Secretary lacked authority to require airports to use historic cost as a basis for airfield fees.

We think Los Angeles' position on this issue is not very persuasive. Section 113, it will be recalled, obliges the Secretary to publish "final regulations, policy statements, or guidelines establishing – . . . the standards or guidelines that shall be used by the Secretary in determining under this section whether an airport fee is reasonable." 49 U.S.C. § 47129(b)(2). That provision certainly implies that Congress intended the Secretary to fashion a quasi-legislative uniform approach to measuring the reasonableness of airport fees. That the Secretary is not authorized actually to set the fee itself means that each airport necessarily has some discretion in the application

of the Secretary's guidelines, but it hardly can be read to mean that the Secretary was not authorized to require a particular methodology for *all* airports – so long as that methodology is itself reasonable.

The more difficult question, posed by ATA, is whether the Secretary's approach to non-airfield fees meets its obligation under § 113. The Secretary's "guideline" seems to be missing a "line." The regulation merely states that *any* reasonable methodology will serve as a basis for non-airfield fees. That concept does not seem to add much – if anything – to the statutory requirement that airport fees be reasonable.[4] It may well be that the Secretary is not required to insist on a single methodology. Perhaps he could indicate that several different methodologies, depending on the circumstances, would be authorized. We need not decide whether the Secretary's treatment of non-airfield fees actually violates his statutory obligation to set forth guidelines, however, because as will be seen, we conclude that in any event his approach is arbitrary and capricious.

III.

Even if the Secretary's regulation as applied to non-airfield fees satisfied § 113's publication obligation, ATA asserts that it amounts to de facto deregulation of those fees – permitting airports to use their market power to charge airlines excessive amounts. Not surprisingly, ATA

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[4] Theoretically, we suppose it might preclude a fee from being thought reasonable, no matter what its amount, if it is reached through a capricious methodology.

wants the Secretary's guidelines for valuing assets in determining airfield fees, based on historic cost, extended to the non-airfield facilities. ATA complains that DOT has not imposed any sort of meaningful restraint on non-airfield revenues, leaving fees to be set by the market. That posture, it is argued, is by definition inconsistent with the reasonableness requirement in the Anti-Head Tax Act, and violates the Secretary's duty under § 113. ATA claims that it is well accepted that an agency responsible for ensuring reasonable rates in industries with anticompetitive conditions may not rely on the market to accomplish that goal. *See, e.g., Federal Power Comm'n v. Texaco, Inc.*, 417 U.S. 380, 397-99, 94 S.Ct. 2315, 2326-27, 41 L.Ed.2d 141 (1974); *Farmers Union Cent. Exch. v. FERC*, 734 F.2d 1486, 1509-10 (D.C.Cir.), *cert. denied*, 469 U.S. 1034, 105 S.Ct. 507, 83 L.Ed.2d 398 (1984); *cf. Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870 (D.C.Cir.1993). Certainly that is so regarding non-airfield fees because, according to ATA, airports enjoy virtually the same market power over non-airfield services – terminals, hangers, cargo space maintenance, etc. – that they do over the airfields. At minimum, therefore, the distinction drawn by the Secretary between the charges for the two types of assets is arbitrary and capricious.

If ATA is correct that the Secretary's regulation imposes no real restraint on airport charges for non-airfield assets and that airports exercise the same, or virtually the same, market power over those assets, then it seems to us that the Secretary's tight regulation of airfield fees – tying them to assets valued at historic cost and capping them at actual cost – is something of an illusion. Most aeronautical users, it would seem, need

both landing fields and non-airfield services. The entire package usually is sold to aeronautical users in one overall fee. Under the "one lump" theory of antitrust law – the proposition that there is only one monopoly rent to be gained from the sale of an end product, *see Western Resources, Inc. v. Surface Transp. Bd.*, 109 F.3d 782, 784 (D.C.Cir.1997) (citing 3 PHILLIP AREEDA & DONALD F. TURNER, ANTITRUST LAW § 725b, at 199 (1978)) – any market power that an airport wants to exercise over airfield fees theoretically may be exercised by increasing the non-airfield portion of the fee.

The Secretary takes no position on the question whether airports have market power over non-airfield facilities, but it is his belief that even if an individual airport does have such power, it will not use it. His explanation, set forth in the basis for the Final Policy and in the briefs before us, is that publicly owned airports do not seek to maximize profits because they do not have the same economic incentives as private investors. And airport authorities may not divert revenues from airports to fund general government facilities, so there is little reason to charge airlines excessive prices. Moreover, even if an airport authority had a desire to build the world's fanciest airport, *see Indianapolis Airport Auth.*, 733 F.2d at 1268, it would be somewhat constrained by competition among airports, at least to be the location of passenger and cargo hubs.

The Secretary thought past experience supported this position: that negotiations for non-airfield fees had not generated controversies, and non-airfield fees had typically produced reasonable results by agreement between

airlines and the airports. But as ATA observes, past litigation had sometimes involved total airport fees, combining both airfield and non-airfield fees. *See Northwest Airlines v. County of Kent*, 738 F.Supp. 1112, 1115 (W.D.Mich.1990), *aff'd*, 955 F.2d 1054 (6th Cir.1992), *aff'd*, 510 U.S. 355, 114 S.Ct. 855, 127 L.Ed.2d 183 (1994); *cf. Indianapolis Airport Auth.*, 733 F.2d at 1265. Be that as it may, experience prior to the Secretary's regulation is not a particularly reliable guide since airports may well have thought that the statutory limitation (reasonableness) on all airport fees prior to 1994 implied some sort of cost-based methodology. *See, e.g., New England Legal Found.*, 883 F.2d at 169; *Indianapolis Airport Auth.*, 733 F.2d at 1271. For the first time, as ATA points out, the Secretary's regulation, allowing *any* reasonable methodology, gives airports much greater assurance that they are free to charge more for non-airfield fees, and there is little reason to expect they will not. Indeed, by linking airfield fees to historic cost and capping airfield fees at total cost but permitting any reasonable methodology and imposing no cap for non-airfield fees, the regulation certainly implies that non-airfield fees need not be cost-based. Nor is the fact that airlines typically have reached agreement with airports as to these fees of any special significance. Airlines have incentives to enter into agreements with airports, even if they are monopolists. And an individual airline may not have a large incentive to challenge the reasonableness of a monopoly rent, since its competitors at an airport would also be paying the same monopoly rent (by virtue of the prohibition against discriminating among aeronautical

users), and any benefit of the litigation would be dispersed among the airlines.[5]

To be sure, the Final Policy allows airlines to challenge the reasonableness of an airport's methodology, so presumably an airline can challenge a non-airfield fee it believes is excessive. But the regulation provides that the Secretary will "not [ ] consider complaints about the reasonableness of fees set by agreement if filed by parties to the agreement," nor does he "expect to investigate routinely fees set by agreement."[6] Airlines are presumably free not to enter into agreements with airports, thereby remaining able to challenge particular non-airfield fees, but we are told that there are certain business reasons that induce airlines to have fee agreements in place. At oral argument, counsel for the Secretary seemed to indicate that airlines would be permitted to enter into agreements under protest and then file complaints under § 113. But that explanation seems inconsistent with the regulation's language, which states that "the threat of a complaint could discourage airport proprietors from putting forward their best offers in negotiations." It is thus not at

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[5] Individual airlines may still not have a strong incentive to challenge monopoly rates under the Final Policy, but the Secretary has (perhaps not unreasonably) interpreted § 113 to permit only airlines, and not trade associations such as ATA, to challenge the reasonableness of aeronautical fees.

[6] Section 113 actually provides that it is inapplicable to fees set by agreement, 49 U.S.C. § 47129(e), but the Secretary "do[es] not interpret [§ 113] to preclude an investigation of fees set by agreement or the application of the policy in such an investigation," 61 Fed.Reg. 31,994, 31,998 (1996), and no one challenges this interpretation.

all clear whether the Final Policy provides airlines with an adequate remedy to challenge non-airfield fees.

Aside from these procedural ambiguities, the Final Policy provides no real guidance as to how the Secretary will determine reasonableness. As we have noted, § 113 may actually require the Secretary to set forth a full quasi-legislative standard rather than developing those standards through a case-by-case approach. Even if the Secretary has more flexible authority under the statute, his regulation surely is inadequate under the APA. The Final Policy indicates that the Secretary will consider "extraordinary situation[s]" (whatever that may mean) in the expedited proceedings under § 113; that the Secretary will consider the reasonableness of non-airfield fees "over the long term and not on the basis of a single year's results"; and that the Secretary will investigate only where there is "a case of progressive accumulation of surplus aeronautical revenue." That the Secretary believes that only a long-term accumulation of surplus aeronautical revenue is evidence of unreasonable non-airfield fees implies that the only legal limit to airport charges is the ability to spend revenues fast enough on airport improvements, including those for non-aeronautical concessions. That approach could lead to competition to build the Taj Mahal of airports. *See Indianapolis Airport Auth.*, 733 F.2d at 1268.

It may well be that, as the Secretary suggests, airports would face some restraint on the exercise of any market power that they might have. But we do not think the Secretary has adequately explained how those generally unspecified restraints will ensure, in the absence of

meaningful guidelines, that non-airfield fees are reasonable. Even assuming, however, that the Secretary on remand can with greater precision identify these restraints and justify notions of reasonableness of some or all aeronautical fees using concepts less restrictive than historic cost, there remains the most serious logical problem with his regulation – which we simply cannot accept. His explanation for the distinction drawn between airfield and non-airfield fees is internally inconsistent. *Cf. Motor Vehicle Mfrs. Ass'n of United States v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 48, 103 S.Ct. 2856, 2869, 77 L.Ed.2d 443 (1983). The obvious difficulty, for instance, with the Secretary's reliance on his perception that public airports are not profit maximizers is that the proposition, if correct, would apply equally to airfield charges, so it hardly can be relied upon to support a different approach to non-airfield fees. Even the specific alleged restraint on the airports' use of market power to charge excessive non-airfield fees – that airports compete to be hub locations – would, if significant, also restrain airfield charges. Surely airlines, when determining where to locate hub facilities, are not indifferent to airfield charges, since they channel their flights in and out of those hub facilities. We are obliged therefore to vacate the rule and remand to the Secretary.

IV.

Los Angeles makes in part the same point: that the Secretary's disparate treatment of airfield and non-airfield charges is arbitrary and capricious, albeit from the perspective of applauding the Secretary's approach to non-airfield charges. The record does not reveal why Los

Angeles is the sole airport owner to challenge the regulation. We know only that it is one of the few (if not the only) municipalities that stopped taking federal grant money – which, as noted, carries with it an obligation to continue using airport facilities as an airport – in the early 1990s.

In any event, Los Angeles' primary attack is directed at the Secretary's requirement of valuing assets at historic cost in calculating airfield charges. The Secretary was careful not to make the same mistake that caused us to reject his prior determination that Los Angeles was obliged to use historic cost as the basis for airfield fees. *See LAX I*, 10[3] F.3d at 1032. Los Angeles then, as now, argued that it should be entitled to use the fair market value of the land – which in downtown Los Angeles is quite dear – as the basis for those charges because it accurately reflects the opportunity cost of devoting LAX to airport use. In the prior proceeding, the Secretary had simply assumed, erroneously we held, that the Anti-Head Tax Act and § 113 require historic cost valuation. This time he did not. He did observe that since airports are obliged to use their property as an airport, the concept of opportunity cost, and therefore fair market value, does not quite fit. (That logic, however, may not apply to Los Angeles.)

The Secretary explained why he thought historic cost was generally preferable to other valuation bases such as fair market value: it is simply easier to administer and less likely to generate controversies. We observed in *LAX I*, however, that valuing land (the principal airfield asset) does not present the same difficulties as valuing, for example, utility plants and equipment, for "there is no

need to reconstruct a hypothetical asset in order to account for technological changes, and there is often (indeed, perhaps usually) a ready market in parcels sufficiently comparable for a professional appraiser to extrapolate with some confidence." 103 F.3d at 1033; *cf. Duquesne Light Co. v. Barasch*, 488 U.S. 299, 308-09, 109 S.Ct. 609, 615-16, 102 L.Ed.2d 646 (1989). Nor has the Secretary actually given any reason to think controversies will be less likely to occur using historic cost. In *LAX I*, the airlines did not contest the accuracy of the appraisal obtained by Los Angeles for the land at LAX, 103 F.3d at 1033; in a later proceeding the airlines' appraisal of the land at LAX was actually *higher* than the airport's; nor is there a guarantee that historic cost will cause few or no disputes. And, so far as we can tell, airports need only appraise the market value of the land once in order to bring it into the rate base. *See id.* Although permitting a methodology other than historic cost valuation might, in the Secretary's words, "turn landing fee disputes into debates between real estate appraisal experts with [the Secretary] in the role of referee," it is not apparent why this justifies requiring historic cost: the Secretary can adopt any number of fairly simple procedures, such as the "final offer" device used in baseball arbitration, *see Southern Pacific Trans. Co. v. ICC*, 69 F.3d 583, 585 (D.C.Cir.1995), for administering such disputes.[7]

Even if ease of determination were an appropriate ground for requiring historic cost valuation of assets in

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[7] By apparently choosing to submit fees to something approaching *de novo* review, the Secretary seems to have burdened himself with administrative difficulties.

determining airfield fees, however, the Secretary's use of it here undermines his treatment of non-airfield fees. By permitting non-airfield fees to be set according to any reasonable methodology, the Final Policy leaves airports free to choose any valuation method, including fair market value; the regulation thus permits airports, in the context of non-airfield fees, to use methodologies that the Secretary has determined are too difficult to use in the context of airfield fees. As Los Angeles puts it, the Secretary simply has not explained why fair market valuation may be appropriate for other portions of the airport, but too difficult to use in valuing airfield assets.

V.

There remains the Secretary's treatment of "imputed interest" which, if anything, is even more puzzling to us than the rest of his rule. The Secretary's Final Policy permits an airport to include in its airfield fees a charge for imputed interest on funds the airport reinvests in its airfield (unless, of course, debt service costs are already included as explicit interest). But airports are only permitted to include such imputed interest in airfield fees insofar as the reinvested funds stem from non-airfield fees, not from airfield fees. The Secretary's rule permits the former, but not the latter, because he reasoned that to charge this cost of capital to the airlines for funds derived from airfield fees would be double charging: the airlines would get stuck with both the excess revenue and the imputed interest on that excess.

ATA objects to paying any imputed interest as part of airfield fees no matter the source of the funds, claiming in

effect that, if it is double charging to charge imputed interest on the funds derived from airfield fees, it is equally double charging to include imputed interest on funds stemming from non-airfield fees. We agree, in a sense, because we do not understand what the Secretary means by double charging. Airports receive revenues from essentially three sources: airfield fees, non-airfield fees, and concession leases. Although airports cannot invest outside the airport, they can reinvest, and indeed may be obliged to reinvest, in all three airport activities – certainly at least the first two. And they have discretion as to the object of their investment, which makes the revenue airports receive from the three sources fungible. Therefore, as the Secretary suggested, there is an opportunity cost in reinvesting in one activity rather than the other two: the forgone revenue that would be received had the airport invested those funds in the other two. There may be a case to be made, similar to the Secretary's argument regarding most airports' lack of opportunity costs generally, that because airports do not have wide discretion as to where they put surplus funds (they cannot invest off airport), their cost of capital (opportunity cost) is less than would be true of another business, but we frankly do not understand the distinction the Secretary makes between funds that stem from airfield fees and those that come from non-airfield fees.

* * *

The Secretary seems to have come up with a rule that represents an overall rough compromise between the interests of most airports and carriers. Unfortunately it is much too rough to withstand judicial review under the

APA. Accordingly, we vacate the rule and remand this proceeding to the Secretary.

AIR TRANSPORT ASSOCIATION OF AMERICA, Petitioner

v.

DEPARTMENT OF TRANSPORTATION, et al., Respondents.

and

Consolidated Case No. 96-1269.

Nos. 96-1253, 96-1269.

United States Court of Appeals,
District of Columbia Circuit.

Oct. 15, 1997.

Before: SILBERMAN, GINSBURG, and HENDERSON, Circuit Judges.

Prior report. 119 F.3d 38

ORDER

PER CURIAM.

On consideration of respondents' petition for rehearing, and the response thereto, it is

ORDERED, by the Court, that the petition for rehearing is granted in part, and the opinion filed on August 1, 1997, is amended as follows:

> Page 15, concluding paragraph, lines 4-6, [119 F.3d at 45] delete the entire last sentence of the opinion and insert in lieu thereof the following: "Accordingly, we vacate the challenged provisions of the Final Policy, paragraphs 2.4, 2.4.1, 2.4.1(a), 2.5.1, 2.5.1(a), 2.5.1(b), 2.5.1(c), 2.5.1(d),

2.5.1(e), 2.5.3, 2.5.3(a), 2.6, the Secretary's supporting discussion in the preamble, and any other portions of the rule *necessarily* implicated by the holding of our opinion, and remand this proceeding to the Secretary. Our action in this case does not reinstate any part of the Secretary's Interim Policy that the Final Policy was intended to replace."

It is **FURTHER ORDERED**, by the Court, that respondents' petition for rehearing is otherwise denied.

APPENDIX B

APPENDIX B

TITLE 49. TRANSPORTATION
SUBTITLE VII. AVIATION PROGRAMS
PART A. AIR COMMERCE AND SAFETY
SUBPART I. GENERAL
CHAPTER 401. GENERAL PROVISIONS

49 USCS § 40116 (1999)

§ 40116. State taxation

* * *

(e) Other allowable taxes and charges. Except as provided in subsection (d) of this section, a State or political subdivision of a State may levy or collect –

(1) taxes (except those taxes enumerated in subsection (b) of this section), including property taxes, net income taxes, franchise taxes, and sales or use taxes on the sale of goods or services; and

(2) reasonable rental charges, landing fees, and other service charges from aircraft operators for using airport facilities of an airport owned or operated by that State or subdivision.

* * *

TITLE 49. TRANSPORTATION
SUBTITLE VII. AVIATION PROGRAMS
PART B. AIRPORT DEVELOPMENT AND NOISE
CHAPTER 471. AIRPORT DEVELOPMENT
SUBCHAPTER I. AIRPORT IMPROVEMENT

49 USCS § 47107 (1999)

§ 47107. Project grant application approval conditioned on assurances about airport operations

(a) General written assurances. The Secretary of Transportation may approve a project grant application under this subchapter [*49 USCS §§ 47101* et seq.] for an airport development project only if the Secretary receives written assurances, satisfactory to the Secretary, that –

(1) the airport will be available for public use on reasonable conditions and without unjust discrimination;

(2) air carriers making similar use of the airport will be subject to substantially comparable charges –

(A) for facilities directly and substantially related to providing air transportation; and

(B) regulations and conditions, except for differences based on reasonable classifications, such as between –

(i) tenants and nontenants; and

(ii) signatory and nonsignatory carriers;

(3) the airport operator will not withhold unreasonably the classification or status of tenant or signatory from an air carrier that assumes obligations substantially

similar to those already imposed on air carriers of that classification or status;

(4) a person providing, or intending to provide, aeronautical services to the public will not be given an exclusive right to use the airport, with a right given to only one fixed-base operator to provide services at an airport deemed not to be an exclusive right if –

(A) the right would be unreasonably costly, burdensome, or impractical for more than one fixed-base operator to provide the services; and

(B) allowing more than one fixed-base operator to provide the services would require reducing the space leased under an existing agreement between the one fixed-base operator and the airport owner or operator;

(5) fixed-base operators similarly using the airport will be subject to the same charges;

(6) an air carrier using the airport may service itself or use any fixed-base operator allowed by the airport operator to service any carrier at the airport;

(7) the airport and facilities on or connected with the airport will be operated and maintained suitably, with consideration given to climatic and flood conditions;

(8) a proposal to close the airport temporarily for a nonaeronautical purpose must first be approved by the Secretary;

(9) appropriate action will be taken to ensure that terminal airspace required to protect instrument and visual operations to the airport (including operations at established minimum flight altitudes) will be cleared and

protected by mitigating existing, and preventing future, airport hazards;

(10) appropriate action, including the adoption of zoning laws, has been or will be taken to the extent reasonable to restrict the use of land next to or near the airport to uses that are compatible with normal airport operations;

(11) each of the airport's facilities developed with financial assistance from the United States Government and each of the airport's facilities usable for the landing and taking off of aircraft always will be available without charge for use by Government aircraft in common with other aircraft, except that if the use is substantial, the Government may be charged a reasonable share, proportionate to the use, of the cost of operating and maintaining the facility used;

(12) the airport owner or operator will provide, without charge to the Government, property interests of the sponsor in land or water areas or buildings that the Secretary decides are desirable for, and that will be used for, constructing at Government expense, facilities for carrying out activities related to air traffic control or navigation;

(13) the airport owner or operator will maintain a schedule of charges for use of facilities and services at the airport –

(A) that will make the airport as self-sustaining as possible under the circumstances existing at the airport, including volume of traffic and economy of collection; and

(B) without including in the rate base used for the charges the Government's share of costs for any project for which a grant is made under this subchapter [*49 USCS §§ 47101* et seq.] or was made under the Federal Airport Act or the Airport and Airway Development Act of 1970;

(14) the project accounts and records will be kept using a standard system of accounting that the Secretary, after consulting with appropriate public agencies, prescribes;

(15) the airport owner or operator will submit any annual or special airport financial and operations reports to the Secretary that the Secretary reasonably requests and make such reports available to the public;

(16) the airport owner or operator will maintain a current layout plan of the airport that meets the following requirements:

(A) the plan will be in a form the Secretary prescribes;

(B) the Secretary will approve the plan and any revision or modification before the plan, revision, or modification takes effect;

(C) the owner or operator will not make or allow any alteration in the airport or any of its facilities if the alteration does not comply with the plan the Secretary approves, and the Secretary is of the opinion that the alteration may affect adversely the safety, utility, or efficiency of the airport; and

(D) when an alteration in the airport or its facility is made that does not conform to the approved plan

and that the Secretary decides adversely affects the safety, utility, or efficiency of any property on or off the airport that is owned, leased, or financed by the Government, the owner or operator, if requested by the Secretary, will –

(i) eliminate the adverse effect in a way the Secretary approves; or

(ii) bear all cost of relocating the property or its replacement to a site acceptable to the Secretary and of restoring the property or its replacement to the level of safety, utility, efficiency, and cost of operation that existed before the alteration was made;

(17) each contract and subcontract for program management, construction management, planning studies, feasibility studies, architectural services, preliminary engineering, design, engineering, surveying, mapping, and related services will be awarded in the same way that a contract for architectural and engineering services is negotiated under title IX of the Federal Property and Administrative Services Act of 1949 *(40 U.S.C. 541* et seq.) or an equivalent qualifications-based requirement prescribed for or by the sponsor;

(18) the airport and each airport record will be available for inspection by the Secretary on reasonable request, and a report of the airport budget will be available to the public at reasonable times and places;

(19) the airport owner or operator will submit to the Secretary and make available to the public an annual report listing in detail –

(A) all amounts paid by the airport to any other unit of government and the purposes for which each such payment was made; and

(B) all services and property provided to other units of government and the amount of compensation received for provision of each such service and property; and

(20) the airport owner or operator will permit, to the maximum extent practicable, intercity buses or other modes of transportation to have access to the airport, but the sponsor does not have any obligation under this paragraph, or because of it, to fund special facilities for intercity bus service or for other modes of transportation.

* * *

(c) Written assurances on acquiring land.

(1) In this subsection, land is needed for an airport purpose (except a noise compatibility purpose) if –

(A) (i) the land may be needed for an aeronautical purpose (including runway protection zone) or serves as noise buffer land; and

(ii) revenue from interim uses of the land contributes to the financial self-sufficiency of the airport; and

(B) for land purchased with a grant the owner or operator received not later than December 30, 1987, the Secretary of Transportation or the department, agency, or instrumentality of the Government that made the grant was notified by the owner or operator of the use of the

land and did not object to the use and the land is still being used for that purpose.

(2) The Secretary of Transportation may approve an application under this subchapter [*49 USCS §§ 47101* et seq.] for an airport development project grant only if the Secretary receives written assurances, satisfactory to the Secretary, that if an airport owner or operator has received or will receive a grant for acquiring land and –

(A) if the land was or will be acquired for a noise compatibility purpose –

(i) the owner or operator will dispose of the land at fair market value at the earliest practicable time after the land no longer is needed for a noise compatibility purpose;

(ii) the disposition will be subject to retaining or reserving an interest in the land necessary to ensure that the land will be used in a way that is compatible with noise levels associated with operating the airport; and

(iii) the part of the proceeds from disposing of the land that is proportional to the Government's share of the cost of acquiring the land will be paid to the Secretary for deposit in the Airport and Airway Trust Fund established under section 9502 of the Internal Revenue Code of 1986 *(26 U.S.C. 9502)* or, as the Secretary prescribes, reinvested in an approved noise compatibility project; or

(B) if the land was or will be acquired for an airport purpose (except a noise compatibility purpose) –

(i) the owner or operator, when the land no longer is needed for an airport purpose, will dispose of the land at fair market value or make available to the Secretary an amount equal to the Government's proportional share of the fair market value;

(ii) the disposition will be subject to retaining or reserving an interest in the land necessary to ensure that the land will be used in a way that is compatible with noise levels associated with operating the airport; and

(iii) the part of the proceeds from disposing of the land that is proportional to the Government's share of the cost of acquiring the land will be reinvested, on application to the Secretary, in another eligible airport development project the Secretary approves under this subchapter [*49 USCS §§ 47101* et seq.] or paid to the Secretary for deposit in the Fund if another eligible project does not exist.

(3) Proceeds referred to in paragraph (2)(A)(iii) and (B)(iii) of this subsection and deposited in the Airport and Airway Trust Fund are available as provided in subsection (f) of this section.

* * *

TITLE 49. TRANSPORTATION
SUBTITLE VII. AVIATION PROGRAMS
PART B. AIRPORT DEVELOPMENT AND NOISE
CHAPTER 471. AIRPORT DEVELOPMENT
SUBCHAPTER I. AIRPORT IMPROVEMENT

49 USCS § 47129 (1999)

§ 47129. Resolution of airport-air carrier disputes concerning airport fees

(a) Authority to request Secretary's determination.

(1) In general. The Secretary of Transportation shall issue a determination as to whether a fee imposed upon one or more air carriers (as defined in section 40102 of this title) by the owner or operator of an airport is reasonable if –

(A) a written request for such determination is filed with the Secretary by such owner or operator; or

(B) a written complaint requesting such determination is filed with the Secretary by an affected air carrier within 60 days after such carrier receives written notice of the establishment or increase of such fee.

(2) Calculation of fee. A fee subject to a determination of reasonableness under this section may be calculated pursuant to either a compensatory or residual fee methodology or any combination thereof.

(3) Secretary not to set fee. In determining whether a fee is reasonable under this section, the Secretary may only determine whether the fee is reasonable or unreasonable and shall not set the level of the fee.

(4) Fees imposed by privately-owned airports. In evaluating the reasonableness of a fee imposed by an

airport receiving an exemption under section 47134 of this title, the Secretary shall consider whether the airport has complied with section 47134(c)(4).

(b) Procedural regulations. Not later than 90 days after August 23, 1994, the Secretary shall publish in the Federal Register final regulations, policy statements, or guidelines establishing –

(1) the procedures for acting upon any written request or complaint filed under subsection (a)(1); and

(2) the standards or guidelines that shall be used by the Secretary in determining under this section whether an airport fee is reasonable.

(c) Decisions by Secretary. The final regulations, policy statements, or guidelines required in subsection (b) shall provide the following:

(1) Not more than 120 days after an air carrier files with the Secretary a written complaint relating to an airport fee, the Secretary shall issue a final order determining whether such fee is reasonable.

(2) Within 30 days after such complaint is filed with the Secretary, the Secretary shall dismiss the complaint if no significant dispute exists or shall assign the matter to an administrative law judge; and thereafter the matter shall be handled in accordance with part 302 of title 14, Code of Federal Regulations, or as modified by the Secretary to ensure an orderly disposition of the matter within the 120-day period and any specifically applicable provisions of this section.

(3) The administrative law judge shall issue a recommended decision within 60 days after the complaint is

assigned or within such shorter period as the Secretary may specify.

(4) If the Secretary, upon the expiration of 120 days after the filing of the complaint, has not issued a final order, the decision of the administrative law judge shall be deemed to be the final order of the Secretary.

(5) Any party to the dispute may seek review of a final order of the Secretary under this subsection in the Circuit Court of Appeals for the District of Columbia Circuit or the court of appeals in the circuit where the airport which gives rise to the written complaint is located.

(6) Any findings of fact in a final order of the Secretary under this subsection, if supported by substantial evidence, shall be conclusive if challenged in a court pursuant to this subsection. No objection to such a final order shall be considered by the court unless objection was urged before an administrative law judge or the Secretary at a proceeding under this subsection or, if not so urged, unless there were reasonable grounds for failure to do so.

(d) Payment under protest; guarantee of air carrier access.

(1) Payment under protest.

(A) In general. Any fee increase or newly established fee which is the subject of a complaint that is not dismissed by the Secretary shall be paid by the complainant air carrier to the airport under protest.

(B) Referral or credit. Any amounts paid under this subsection by a complainant air carrier to the airport

under protest shall be subject to refund or credit to the air carrier in accordance with directions in the final order of the Secretary within 30 days of such order.

(C) Assurance of timely repayment. In order to assure the timely repayment, with interest, of amounts in dispute determined not to be reasonable by the Secretary, the airport shall obtain a letter of credit, or surety bond, or other suitable credit facility, equal to the amount in dispute that is due during the 120-day period established by this section, plus interest, unless the airport and the complainant air carrier agree otherwise.

(D) Deadline. The letter of credit, or surety bond, or other suitable credit facility shall be provided to the Secretary within 20 days of the filing of the complaint and shall remain in effect for 30 days after the earlier of 120 days or the issuance of a timely final order by the Secretary determining whether such fee is reasonable.

(2) Guarantee of air carrier access. Contingent upon an air carrier's compliance with the requirements of paragraph (1) and pending the issuance of a final order by the Secretary determining the reasonableness of a fee that is the subject of a complaint filed under subsection (a)(1)(B), an owner or operator of an airport may not deny an air carrier currently providing air service at the airport reasonable access to airport facilities or service, or otherwise interfere with an air carrier's prices, routes, or services, as a means of enforcing the fee.

(e) Applicability. This section does not apply to –

(1) a fee imposed pursuant to a written agreement with air carriers using the facilities of an airport;

(2) a fee imposed pursuant to a financing agreement or covenant entered into prior to August 23, 1994; or

(3) any other existing fee not in dispute as of August 23, 1994.

(f) Effect on existing agreements. Nothing in this section shall adversely affect –

(1) the rights of any party under any existing written agreement between an air carrier and the owner or operator of an airport; or

(2) the ability of an airport to meet its obligations under a financing agreement, or covenant, that is in force as of August 23, 1994.

(g) Definition. In this section, the term "fee" means any rate, rental charge, landing fee, or other service charge for the use of airport facilities.

TITLE 49 APPENDIX. TRANSPORTATION
CHAPTER 20. FEDERAL AVIATION ACT
MISCELLANEOUS

49 USCS Appx § 1513 (1988 & Supp. 1993)

§ 1513. State taxation of air commerce

* * *

(b) Permissible State taxes and fees. Except as provided in subsection (d) of this section, nothing in this section shall prohibit a State (or political subdivision thereof, including the Commonwealth of Puerto Rico, the Virgin Islands, Guam, the District of Columbia, the territories or possessions of the United States or political agencies of two or more States) from the levy or collection of taxes other than those enumerated in subsection (a) of this section, including property taxes, net income taxes, franchise taxes, and sales or use taxes on the sale of goods or services; and nothing in this section shall prohibit a State (or political subdivision thereof, including the Commonwealth of Puerto Rico, the Virgin Islands, Guam, the District of Columbia, the territories or possessions of the United States or political agencies of two or more States) owning or operating an airport from levying or collecting reasonable rental charges, landing fees, and other service charges from aircraft operators for the use of airport facilities.

* * *

TITLE 49 APPENDIX. TRANSPORTATION
CHAPTER 31. AIRPORT AND AIRWAY IMPROVEMENT

49 USCS Appx § 2210 (1988 & Supp. 1993)

§ 2210. Project sponsorship

(a) Sponsorship. As a condition precedent to approval of an airport development project contained in a project grant application submitted under this title, the Secretary shall receive assurances, in writing, satisfactory to the Secretary, that –

(1) the airport to which the project relates will be available for public use on fair and reasonable terms and without unjust discrimination, including the requirement that (A) each air carrier using such airport (whether as a tenant, nontenant, or subtenant of another air carrier tenant) shall be subject to such nondiscriminatory and substantially comparable rates, fees, rentals, and other charges with respect to facilities directly and substantially related to providing air transportation and such nondiscriminatory and substantially comparable rules, regulations, and conditions as are applicable to all such air carriers which make similar use of such airport and which utilize similar facilities, subject to reasonable classifications such as tenants or nontenants, and signatory carriers and nonsignatory carriers, and such classification or status as tenant or signatory shall not be unreasonably withheld by any airport provided an air carrier assumes obligations substantially similar to those already imposed on air carriers in such classification or status, and (B) each fixed-based operator at any airport shall be subject to the same rates, fees, rentals, and other charges as are uniformly applicable to all other fixed-based operators

making the same or similar uses of such airport utilizing the same or similar facilities, and (C) each air carrier using such airport shall have the right to service itself or to use any fixed-based operator that is authorized by the airport or permitted by the airport to serve any air carrier at such airport;

(2) there will be no exclusive right for the use of the airport by any person providing, or intending to provide, aeronautical services to the public. For purposes of this paragraph, the providing of services at an airport by a single fixed-based operator shall not be construed as an exclusive right if it would be unreasonably costly, burdensome, or impractical for more than one fixed-based operator to provide such services, and if allowing more than one fixed-based operator to provide such services would require the reduction of space leased pursuant to an existing agreement between such single fixed-based operator and such airport;

(3) the airport and all facilities thereon or connected therewith will be suitably operated and maintained, with due regard to climatic and flood conditions, and any proposal to temporarily close the airport for nonaeronautical purposes must first be approved by the Secretary;

(4) appropriate action will be taken to assure that such terminal airspace as is required to protect instrument and visual operations to the airport (including established minimum flight altitudes) will be adequately cleared and protected by removing, lowering, relocating,

marking, or lighting or otherwise mitigating existing airport hazards and by preventing the establishment or creation of future airport hazards;

(5) appropriate action, including the adoption of zoning laws has been or will be taken, to the extent reasonable, to restrict the use of land adjacent to or in the immediate vicinity of the airport to activities and purposes compatible with normal airport operations, including landing and takeoff of aircraft;

(6) all of the facilities of the airport developed with Federal financial assistance and all those usable for landing and takeoff of aircraft will be available to the United States for use by Government aircraft in common with other aircraft at all times without charge, except, if the use by Government aircraft is substantial, charge may be made for a reasonable share, proportional to such use, of the cost of operating and maintaining the facilities used;

(7) the airport operator or owner will furnish without cost to the Federal Government for use in connection with any air traffic control or navigation activities, or weather-reporting and communication activities related to air traffic control, any areas of land or water, or estate therein, or rights in buildings of the sponsor as the Secretary considers necessary or desirable for construction at Federal expense of space or facilities for such purposes;

(8) all project accounts and records will be kept in accordance with a standard system of accounting prescribed by the Secretary after consultation with appropriate public agencies;

(9) the airport operator or owner will maintain a fee and rental structure for the facilities and services being provided the airport users which will make the airport as self-sustaining as possible under the circumstances existing at that particular airport, taking into account such factors as the volume of traffic and economy of collection, except that no part of the Federal share of an airport development or airport planning project for which a grant is made under this title or under the Federal Airport Act or the Airport and Airway Development Act of 1970 shall be included in the rate base in establishing fees, rates, and charges for users of that airport;

(10) the airport operator or owner will submit to the Secretary such annual or special airport financial and operations reports as the Secretary may reasonably request;

(11) the airport and all airport records will be available for inspection by any duly authorized agent of the Secretary upon reasonable request and a report of the airport budget will be available to the public at reasonable times and places;

(12) all revenues generated by the airport, if it is a public airport, and any local taxes on aviation fuel (other than taxes in effect on the date of the enactment of the Airport and Airway Safety and Capacity Expansion Act of 1987 [enacted Dec. 30, 1987]) will be expended for the capital or operating costs of the airport, the local airport system, or other local facilities which are owned or operated by the owner or operator of the airport and

directly and substantially related to the actual air transportation of passengers or property; except that if covenants or assurances in debt obligations issued before September 3, 1982, by the owner or operator of the airport, or provisions enacted before September 3, 1982, in the governing statutes controlling the owner or operator's financing, provide for the use of the revenues from any of the airport owner or operator's facilities, including the airport, to support not only the airport but also the airport owner or operator's general debt obligations or other facilities, then this limitation on the use of all other revenues generated by the airport (and, in the case of a public airport, local taxes on aviation fuel) shall not apply;

(13) if the airport operator or owner receives a grant before, on, or after the date of the enactment of this paragraph [enacted Dec. 30, 1987] for the purchase of land for airport noise compatibility purposes –

(A) the owner or operator will, when the land is no longer needed for such purposes, dispose of such land at fair market value at the earliest practicable time;

(B) such disposition will be subject to the retention or reservation of any interest or right therein necessary to ensure that such land will only be used for purposes which are compatible with noise levels associated with the operation of the airport; and

(C) that portion of the proceeds of such disposition which is proportionate to the United States share of the cost of acquisition of such land will, at the discretion of the Secretary –

(i) be paid to the Secretary for deposit in the Trust Fund; or

(ii) be reinvested in an approved noise compatibility project as prescribed by the Secretary;

(14) if the airport operator or owner receives a grant before, on, or after December 31, 1987, for the purchase of land for airport development purposes (other than noise compatibility purposes) –

(A) the owner or operator will, when the land is no longer needed for airport purposes, dispose of such land at fair market value or make available to the Secretary an amount equal to the United States proportionate share of the fair market value of the land;

(B) such disposition will be subject to the retention or reservation of any interest or right therein necessary to ensure that such land will only be used for purposes which are compatible with noise levels associated with the operation of the airport;

(C) that portion of the proceeds of such disposition which is proportionate to the United States share of the cost of acquisition of such land will –

(i) upon application to the Secretary, be reinvested in another eligible airport improvement project or projects approved by the Secretary at that airport or within the national airport system; or

(ii) be paid to the Secretary for deposit in the Trust Fund if no such eligible project exists;

subject to the requirement that land shall be considered to be needed for airport purposes under this paragraph if

(I) it may be needed for aeronautical purposes (including runway protection zone) or serves as noise buffer land and (II) the revenue from interim uses of such land contributes to the financial self-sufficiency of the airport, and subject to the further requirement that land purchased with a grant received by an airport operator or owner before December 31, 1987, will be considered to be needed for airport purposes if the Secretary or the Federal agency making such grant before December 31, 1987, was notified by the operator or owner of the use of such land, did not object to such use, and the land continues to be used for that purpose;

(15) the airport owner or operator will keep up to date at all times a layout plan of the airport which meets the following requirements:

(A) the plan will be in a form prescribed by the Secretary;

(B) before the plan and an amendment, revision, or modification thereof may take effect, the plan, amendment, revision, or modification will be submitted to, and receive approval of, the Secretary;

(C) the owner or operator will not make or permit any changes or alterations in the airport or in any of its facilities which are not in conformity with the airport layout plan as approved by the Secretary and which might, in the opinion of the Secretary, adversely affect the safety, utility, or efficiency of the airport;

(D) if a change or alteration in the airport or its facilities is made which the Secretary determines adversely affects the safety, utility, or efficiency of any

federally owned, leased, or funded property on or off the airport and which is not in conformity with the airport layout plan as approved by the Secretary, the owner or operator will, if requested by the Secretary –

(i) eliminate such adverse effect in a manner approved by the Secretary; or

(ii) bear all costs of relocating such property (or replacement thereof) to a site acceptable to the Secretary and all costs of restoring such property (or replacement thereof) to the level of safety, utility, efficiency, and cost of operation existing before the unapproved change in the airport or its facilities;

(16) each contract or subcontract for program management, construction management, planning studies, feasibility studies, architectural services, preliminary engineering, design, engineering, surveying, mapping, or related services with respect to the project will be awarded in the same manner as a contract for architectural and engineering services is negotiated under title IX of the Federal Property Administrative Services Act of 1949 [40 USCS §§ 541 et seq.] or an equivalent qualifications-based requirement prescribed for or by the sponsor of the airport; and

(17) the airport owner or operator will take such action as may be necessary to ensure that, to the maximum extent practicable, at least 10 percent of all businesses at the airport which sell food, beverages, printed materials, or other consumer products or which provide ground transportation, baggage carts, automobile rentals, or other consumer services to the public are small business concerns (as defined by the Secretary

by regulation) owned and controlled by socially and economically disadvantaged individuals (as defined under section 505(d)(2)(B) [49 USCS Appx. § 2204(d)(2)(B)]).

* * *

Nos. 99-466 & 99-500

Supreme Court, U.S.
FILED
NOV 22 1999
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

CITY OF LOS ANGELES, *et al.*,
Petitioners,

and

AIRPORTS COUNCIL INTERNATIONAL – NORTH AMERICA,
Petitioner,

v.

UNITED STATES DEPARTMENT OF TRANSPORTATION, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF IN OPPOSITION FOR RESPONDENTS AIR TRANSPORT ASSOCIATION OF AMERICA, *et al.*

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QUESTION PRESENTED

Whether the Court of Appeals properly determined that the Department of Transportation did not act arbitrarily or capriciously in finding that a component of the landing fee imposed on airlines by respondents City of Los Angeles, *et al.* for use of the Los Angeles International Airport was unreasonable under the Anti-Head Tax Act, 49 U.S.C. § 40116, because it did not correspond to any legitimate aeronautical cost.

PARTIES TO THE PROCEEDINGS AND RULE 26.1 STATEMENTS

In addition to the parties set forth in the petitions for certiorari, the following is a list of additional parties (together with their statements pursuant to S. Ct. R. 26.1) which were intervenors below in support of the United States Department of Transportation, *et al.* and which are respondents in this Court pursuant to S. Ct. R. 12.6:

Air Canada states that it has no parent companies and that there are no publicly held corporations that own 10% or more of its stock.

Air New Zealand Ltd. Airlines states that its parent company is Air New Zealand Limited Group and that there are no other publicly held corporations that own 10% or more of its stock.

Alaska Airlines, Inc. states that its parent company is Alaska Air Group, Inc. and that there are no other publicly held corporations that own 10% or more of its stock.

America West Airlines, Inc. states that its parent company is America West Holdings Corporation and that there are no other publicly held corporations that own 10% or more of its stock.

American Airlines, Inc. states that its parent company is AMR, Inc. and that there are no other publicly held corporations that own 10% or more of its stock.

American Trans Air, Inc. states that its parent company is Amtran, Inc. and that there are no other publicly held corporations that own 10% or more of its stock.

Continental Airlines, Inc. states that it has no parent companies and that Northwest Airlines Corporation owns 10% or more of its stock.

Delta Air Lines, Inc. states that it has no parent companies and that there are no publicly held corporations that own 10% or more of its stock.

Koninklijke Luchtvaart Maatschappij N.V. d/b/a KLM-Royal Dutch Airlines states that it has no parent companies and that there are no publicly held corporations that own 10% or more of its stock.

Compañía Mexicana de Aviación, S.A. de C.V. d/b/a Mexicana Airlines states that its parent company is Corporación Mexicana de Aviacion S.A. de C.V. and that there are no other publicly held corporations that own 10% or more of its stock

Southwest Airlines Co. states that it has no parent companies and that there are no publicly held corporations that own 10% or more of its stock.

Trans World Airlines, Inc. (TWA) states that it has no parent companies and that there are no publicly held corporations that own 10% or more of its stock.

United Airlines, Inc. states that its parent company is UAL Corporation and that there are no other publicly held corporations that own 10% or more of its stock.

United Parcel Service Co. states that its parent company is United Parcel Service, Inc. and that there are no other publicly held corporations that own 10% or more of its stock.

US Airways, Inc. states that its parent company is US Airways Group, Inc. and that there are no other publicly held corporations that own 10% or more of its stock.

Viacao Aerea Rio-Grandense d/b/a Varig Brazilian Airlines states that it has no parent companies and that there are no publicly held corporations that own 10% or more of its stock.

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IN THE

Supreme Court of the United States

Nos. 99-466 & 99-500

CITY OF LOS ANGELES, *et al.*,

Petitioners,

and

AIRPORTS COUNCIL INTERNATIONAL – NORTH AMERICA,

Petitioner,

v.

DEPARTMENT OF TRANSPORTATION, *et al.*,

Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF IN OPPOSITION FOR RESPONDENTS AIR TRANSPORT ASSOCIATION OF AMERICA, *et al.*

Respondents Air Transport Association of America, *et al.*—the original complainants in the administrative proceedings below and intervenors in the Court of Appeals—hereby oppose the petitions for certiorari filed in this case by the City of Los Angeles, *et al.* (collectively, "the City") in

No. 99-466 and by the Airports Council International-North America ("ACI") in No. 99-500.[1]

INTRODUCTION

This case meets none of the criteria warranting certiorari. *See* S. Ct. R. 10. It implicates no conflict among the circuits and raises no important unsettled question of law. To the contrary, this case involves an ordinary exercise of agency discretion in determining the reasonableness of a rate subject to federal regulation. Like other similar regulatory statutes, the Anti-Head Tax of 1973 ("AHTA"), codified as amended at 49 U.S.C. § 40116, requires airports to assess only "reasonable" charges on aeronautical users. *See generally Northwest Airlines, Inc. v. County of Kent*, 510 U.S. 355 (1994) ("*Kent County*"). Pursuant to its expressly delegated authority to implement that statute, the Department of Transportation ("DOT") disallowed a portion of the fees charged by the City for the use of the Los Angeles International Airport ("LAX"). Applying the deferential standard of review this Court has squarely held is applicable to such agency policy determinations, *see id.* at 367, the Court of Appeals denied the City's petition for review, holding that DOT's determination was not arbitrary or capricious.

In a misguided attempt to transform this ordinary administrative rate proceeding into a case worthy of this Court's review, the City and ACI primarily present issues that were not raised below and that are not implicated by this case. For example, they argue that this case conflicts with circuit court decisions involving the standard of review for an agency's interpretation of federal grant agreements. Yet no party

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[1] This brief is filed on behalf of the Air Transport Association of America ("ATA") and the sixteen original complainant airlines listed above at pages ii-iii. A total of 59 airlines eventually participated in the administrative proceedings, and this brief will refer to all of them collectively as the "Airlines." All of the Airlines are now jointly represented in the administrative proceedings below.

raised that argument below—or even cited to those purportedly conflicting cases—because there is no dispute in this case as to the proper interpretation of the City's grants. The City's grants were involved here only to the extent that DOT considered certain unambiguous grant requirements as one factor supporting its determination as to the unreasonableness of the City's fees. Likewise, ACI's petition belatedly presents—for the first time in this case—an issue under the Tenth Amendment that has nothing to do with the rate regulation issues that are the real subject of this case.

Despite petitioners' attempt to manufacture new issues at this late stage of the proceedings, this case involves a straightforward application of the deference which this Court has clearly held is applicable to DOT airport rate determinations. And far from constituting a question of national importance, the underlying issue is unique because no other airport has ever attempted to impose the type of charges which DOT found unreasonable in this case. The petitions should therefore be denied.

COUNTERSTATEMENT

A. The City's New Fees

Federal law has long mandated that airport proprietors receiving federal grants must use all airport revenues only for airport operating and capital costs. *See* 49 U.S.C. § 47107(b). Nevertheless, beginning in the early 1990s, the City openly embarked on a campaign to balance its local budget by assessing new fees on the air traveling and shipping public—fees designed to earn significantly more than necessary to cover the costs of delivering service to those users—and then diverting those excess revenues to general City activities. This publicly-announced plan is fully documented in the record, which contains numerous public statements and actions by City officials evidencing the City's

intent. *See, e.g.*, J.A. 137, 151-153, 154, 155-156, 162-168, 227-229, 230.[2]

The centerpiece of the plan was the development of a new fee methodology expressly designed to create surpluses for eventual diversion. In furtherance of that strategy, the City commissioned a consultant to identify methods of achieving the City's goals. *See* J.A. 161, 187, 202, 212, 213. The consultant recommended that the City replace its residual fee methodology with a new "cost of service" (or "compensatory") methodology that would generate large surpluses. J.A. 216. A compensatory methodology is supposed to set aeronautical user fees at the amount necessary to cover the airport's actual costs of serving those users. *See City of Los Angeles Department of Airports v. DOT*, 103 F.3d 1027, 1029 (D.C. Cir. 1997). The consultant, however, specifically advised the City that it could maximize LAX "discretionary cash flow" (*i.e.*, generate a revenue surplus) if it included in the rate base items such as land rental charges that do not compensate for any out-of-pocket costs. J.A. 225.

The purpose of the new fees was clear. Indeed, the consultant explicitly acknowledged that "[t]he use of airport revenues and the establishment of landing fees are interrelated," J.A. 189, and recommended the adoption of a " 'dividend' policy to transfer 'airport revenues' to the [City's] general fund, notwithstanding the current limitations on such transfers." J.A. 191. The consultant explained that such "dividends" were "nothing more than a transfer to the general fund" that could be calculated in part by "a Land Rent Formula." J.A. 193-194. This proposal was a dramatic departure from traditional airport practices in the United States. As the consultant recognized, LAX "would be the first U.S. airport" to use fair market valuation to set landing fees. J.A. 222; *see also* J.A. 169-170 (hearing testimony).

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[2] "J.A." refers to the Joint Appendix filed below.

The record also demonstrates that the City had no need for these surpluses other than for the proposed diversion. As DOT found, the net income of the City's Department of Airports was $71 million in 1993-94, yielding an operating profit margin of nearly *40%*. J.A. 507. Its retained earnings also increased by more than $100 million in 1993-94, to $825,071,000. *Compare* J.A. 198, *with* J.A. 235; *see* J.A. 157-158. And unaudited financial statements for the first six months of 1994-95 showed an additional $65 million increase in retained earnings. J.A. 260A; J.A. 158-160.

B. The Administrative Proceedings

In 1994, responding to this Court's suggestions that airport rate determinations are best left to the discretion of an expert agency, *see Kent County*, 510 U.S. at 367, Congress enacted 49 U.S.C. § 47129 ("Section 47129"), which established an expedited procedure under which airlines may challenge the reasonableness of airport user fees before DOT. After enactment of the statute, the original complainant airlines (joined later by the other Airlines) filed administrative proceedings challenging the legitimacy of the City's 1993 fees and, thereafter, its 1995 fees.

The Airlines presented more than a hundred documentary exhibits and declarations supporting their complaint. After DOT found there was a "significant dispute" pursuant to Section 47129(c)(2), the matter proceeded to a hearing. Affirming a recommended decision of its Chief Administrative Law Judge, DOT determined (among other things) that the City's land rental charges were unreasonable and therefore invalid because they did not correspond to any valid airport cost.

C. The *LAX I* and *Policy Appeal* Decisions

The City petitioned the Court of Appeals for review of that decision, and in *City of Los Angeles Department of Airports v. DOT*, 103 F.3d 1027 (D.C. Cir. 1997) ("*LAX I*"), the court

remanded the case for further consideration. The court recognized that by adopting a compensatory methodology the City became obligated to set fees based upon "the actual costs to the City of maintaining and operating the airfield and the apron." *Id.* at 1029. But the Court held that DOT had incorrectly determined, as a matter of law, that the governing statutes allowed airports to recover only their out-of-pocket costs, and that DOT therefore had failed even to consider the City's contention that purported lost "opportunity costs" rendered its land rental charges reasonable. Accordingly, the court remanded the case with directions that the agency give "express consideration" to the City's argument that one of its "actual costs" is the "opportunity cost" it experiences by foregoing the value the City could obtain from the airfield land in the best alternative use. *Id.* at 1033-34.

Subsequently, the Court of Appeals ruled on the City's and ATA's petitions for review of DOT's revised Policy Regarding Airport Rates and Charges. *See Air Transport Ass'n of America v. DOT*, 119 F.3d 38 (D.C. Cir.), *amended by*, 129 F.3d 625 (D.C. Cir. 1997) ("*Policy Appeal*"). In ruling on the City's petition, the court held that DOT had not adequately explained its requirement that airports using compensatory methodologies must value land at historic cost. The court, however, concluded that DOT did not "make the same mistake that caused us to reject [its] prior determination that Los Angeles was obliged to use historic cost as the basis for airfield fees"—*i.e.*, that the statute itself required such valuation. *Id.* at 44. In particular, as the court noted, DOT fully addressed the City's opportunity cost argument, "observ[ing] that since airports are obliged to use their property as an airport, the concept of opportunity cost, and therefore fair market value, does not quite fit." *Id.* Even though the City challenged the rationality of this policy judgment, the court did *not* accept the City's arguments on that point. Instead, it faulted DOT for not adequately explaining why

administrative difficulties favored historic cost for airfield fees but not for non-airfield fees. *Id.* at 43-44.

D. The Remand Decision

On remand following *LAX I*, after carefully considering all of the parties' arguments regarding the reasonableness of the land rental charge, DOT issued its final decision. DOT determined that the City incurs no compensable opportunity costs by devoting its airfield land to that use because the City has no current opportunity to use the land for any other purpose, in light of its unambiguous voluntary grant assurances requiring it to use the land as an airport, as well as the practical impossibility of relocating LAX. Pet. App. 38a-44a, 46a-47a.[3]

DOT further determined that, even if the City had such opportunities, it incurs no net opportunity costs (and needs no additional monetary incentives) because it earns substantial monopoly-level profits from its unregulated non-aeronautical activities and because LAX bestows substantial benefits on the City. *Id.* at 39a n.7, 49a-52a. DOT also relied on the fact that LAX, among the many airports that have employed compensatory methodologies, is the *only* airport to have abandoned the universal practice of valuing airfield land at historic cost. *Id.* at 55a-58a. And in rejecting the City's contention that its land rental charge was needed for capital improvements, DOT found that the evidence did not support that contention but rather "suggests that the airport instead may have adopted that formula in order to raise funds that could be diverted off the airport if federal law were changed to allow that diversion of airport revenues." *Id.* at 62a.

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[3] "Pet. App." refers to the Appendix to the Petition in No. 99-466.

E. The Decision Below

The Court of Appeals denied the City's petition for review of the remand decision. The court noted that, unlike in the agency's original decision, in its remand decision DOT "rested its decision explicitly on policy grounds." Pet. App. 6a. The court thus recognized that

> [i]n reviewing the Department's order, we do not sit as a panel of referees on a professional economics journal, but as a panel of generalist judges obliged to defer to a reasonable judgment by an agency acting pursuant to congressionally delegated authority.

Id. at 10a (citing, *inter alia*, *Kent County*, 510 U.S. at 366-368).

Applying these well-settled principles of agency review, the court concluded that DOT's rejection of the City's "opportunity cost" argument was not arbitrary or capricious. Noting that the City's grant assurances unambiguously require it to maintain LAX as an airport, *see* 49 U.S.C. § 47107(a)(1), (a)(16)(c), and therefore eliminate any current opportunity to use its airfield land for something else, the court held that "we cannot say it was irrational for the Department to treat the grant assurances as a given and evaluate the City's proposed methodology from that perspective." Pet. App. 11a. The court also rejected the City's argument that upholding DOT's remand decision was inconsistent with the court's prior decision in *LAX I*. *Id.* at 12a-13a.

The court likewise rejected ACI's argument that by evaluating the City's opportunity cost argument with reference to the City's unambiguous grant assurances, DOT impermissibly added a new condition to those grants. As the court held, "we do not view the Department's reasoning as adding new conditions to the grant. Rather, the Department focused on a *consequence* of an unambiguously imposed condition—that

the airport would be kept open for public use—that was present from the outset." *Id.* at 13a (emphasis in original).

Finally, the court noted that DOT's decision could also be sustained on the alternative ground that it was reasonable for DOT to conclude that any purported opportunity costs incurred by the City in not using its land as an airport are covered by the enormous (and undisputed) benefits bestowed on the City by using the land for that purpose. *Id.* at 13a-15a. The court rejected the City's contention that by evaluating its opportunity cost argument with reference to these benefits, DOT contravened *Kent County*, *supra*, which holds that an airport employing a compensatory methodology need not cross-credit non-aeronautical revenues against aeronautical costs. *See also* 49 U.S.C. § 47129(a)(2) (permitting airports to use compensatory methodologies). As the court held:

> [T]he Department in no sense adopted a general requirement that airports must credit their non-airfield surpluses toward their airfield costs. The DOT is only taking into account non-airfield revenues, as well as all other economic benefits the City enjoys, in determining whether Los Angeles really has an uncovered opportunity cost. It is the City itself, by using the opportunity costs concept, that has invited the Department to think broadly about how such costs should be measured.

Pet. App. 14a.[4]

The court then denied the City's and ACI's petitions for rehearing and rejected their suggestions for rehearing *en banc*. Two non-panel judges dissented from this order, expressing the view that "another remand to [DOT] seems . . . in order" so that DOT might "resolv[e] other possible

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[4] The court also rejected the City's independent claim that DOT's decision effected an unconstitutional taking of its property. Pet. App. 15a-17a. Neither petition presents that issue for this Court's review.

theories supporting its rejection of opportunity costs." *Id.* at 116a, 115a. Judge Silberman, in an opinion concurring in the denial of rehearing, reiterated the panel's holding that DOT's decision was entitled to deference. But Judge Silberman also noted that, as a purely economic matter, the record evidence did not support the City's contention that "having taken taxpayer money under the condition that it would continue to use LAX as an airport [the City] is legally entitled to charge a significant group of those taxpayers, airline passengers flying in and out of LAX, its opportunity cost based on a nonexistent opportunity . . . ." *Id.* at 111a.

Yet while the dissenting judges (both of whom were on the panel that decided *LAX I*) apparently would have remanded the case yet again, they did not express the view that the decision below conflicted with *LAX I*. Likewise, no judge of the Court of Appeals, or any other court, has in any way intimated that the decision below conflicts with any other decision from any court.

REASONS FOR DENYING THE WRIT

I. THE DECISION BELOW DOES NOT CONFLICT WITH THE DECISION OF ANY OTHER COURT

A. The Court of Appeals Correctly Applied This Court's Longstanding Precedents Governing Review of Administrative Rate Determinations

Six years ago, in its brief to this Court in *Kent County*, the City quite clearly stated its position that "[h]istorically, federal courts have declined to involve themselves in ratemaking" and that "accepted principles of deference to agency interpretation" required that this Court accept what the City understood to be DOT's interpretation of the Anti-Head Tax Act in that case. Brief for City of Los Angeles as Amicus Curiae in Support of Respondents at 12, 14, *Northwest Airlines, Inc. v. County of Kent*, No. 92-97.

This Court adopted that view in *Kent County*. As the Court held:

> Courts . . . are scarcely equipped to oversee, without the initial superintendence of a regulatory agency, rate structures and practices. The Secretary of Transportation is charged with administering the federal aviation laws, including the AHTA. His Department is equipped, as courts are not, to survey the field nationwide, and to regulate based on a full view of the relevant facts and circumstances. If we had the benefit of the Secretary's reasoned decision concerning the AHTA's permission for the charges in question, we would accord that decision substantial deference. See *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-845 (1984).

510 U.S. at 366-367 (additional citations and footnote omitted).

Likewise, although the decision in *Kent County* (which did not involve review of an agency decision) applied a reasonableness standard derived from Commerce Clause jurisprudence, the Court also made clear that

> [i]t remains open to the Secretary, utilizing his Department's capacity to comprehend the details of airport operations across the country, and the economics of the air transportation industry, to apply some other formula (including one that entails more rigorous scrutiny) for determining whether fees are "reasonable" within the meaning of the AHTA; his exposition will merit judicial approbation so long as it represents "a permissible construction of the statute." *Chevron*, 467 U.S. at 843.

Id. at 368 n.14.[5]

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[5] Subsequently, Congress enacted Section 47129, which established the expedited rate-review procedures that were invoked in this case. Following this Court's guidance, Congress expressly provided that "[a]ny findings of fact in a final order of the Secre-

Thus, *Kent County* clearly sets forth the applicable standard for reviewing DOT decisions regarding the reasonableness of airport rates under the AHTA. As with other such agency decisions, the standard of review is highly deferential. Indeed, because an agency rate decision " 'is essentially a legislative function,' " *Kent County*, 510 U.S. at 366 (quoting *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 589 (1945)), it has long been recognized that an administrative agency charged with determining the reasonableness of rates "must be free, within the limitations imposed by pertinent constitutional and statutory commands, to devise methods of regulation capable of equitably reconciling diverse and conflicting interests." *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968).

Yet after having itself successfully urged this Court to apply "accepted principles of deference" to DOT decisions regarding the reasonableness of airport rates, *see supra* at 10, the City now contends that "the court of appeals applied an improperly deferential standard of review." City Pet. at 17. In *Kent County*, the City urged a deferential standard of review because it believed that DOT's position was favorable to it in that case, and the Court endorsed that view. The City now takes the opposite view because DOT has not agreed with its position in this case. The application of *Chevron* deference, however, does not turn on which party prevails before the agency.

In an attempt to manufacture an issue for certiorari where none exists, the City and ACI contend that the decision below conflicts with the decisions of other courts addressing the standard of review for an agency interpretation of a federal grant provision. *See* City Pet. at 17-21; ACI Pet. at 15 (citing *Virginia Dep't of Educ. v. Riley*, 106 F.3d 559 (4th Cir. 1997)); *cf. Doe v. Board of Educ. of Oak Park & River*

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tary . . . if supported by substantial evidence, shall be conclusive if challenged in a court . . . ." 49 U.S.C. § 47129(c)(6).

Forest High Sch. Dist. 200, 115 F.3d 1273 (7th Cir.) (following *Riley* without independent analysis), *cert. denied*, 118 S. Ct. 564 (1997)). The Court of Appeals would undoubtedly be surprised to learn that its decision conflicted with these other circuit court decisions. For neither the City nor ACI ever raised this argument below (either before the panel or on rehearing), neither of them even *cited* to the allegedly conflicting cases, and the Court of Appeals did not address the issue on its own. Accordingly, even if this case involved a question regarding the proper standard for reviewing agency interpretation of grant agreements—which, as explained below, it does not—the issue has been waived.[6]

It is not surprising that the City and ACI did not raise this issue below, for there is no question in this case regarding the proper interpretation of the City's grant agreements. As in *Kent County*, this case involves the application of the general requirement of the AHTA that airports may assess only "reasonable" user fees. 49 U.S.C. § 40116(e)(2). This requirement is *independent* of any grant assurances.[7] The City contended that its land rental fees were reasonable in

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[6] *See, e.g., Department of Revenue v. Kurth Ranch*, 511 U.S. 767, 772 n.9 (1994) ("The issue was not raised below, so we do not address it."); *Heller v. Doe*, 509 U.S. 312, 319 (1993) ("It would be imprudent and unfair to inject a new standard at this stage in the litigation. We therefore decide this case as it has been presented to the courts whose judgments are being reviewed.") (citations omitted); *Sisson v. Ruby*, 497 U.S. 358, 359 n.1 (1990) ("We decline to consider that argument because it was not raised below."); *Delta Air Lines, Inc. v. August*, 450 U.S. 346, 362 (1981) ("that question was not raised in the Court of Appeals and is not properly before us").

[7] The City's grant assurances also contain a similar provision requiring it to make its airport available "on fair and reasonable terms." 49 U.S.C. App. § 2210(a)(1) (1988) (since recodified as "reasonable conditions," 49 U.S.C. § 47107(a)(1)). Because the AHTA independently forbids the City from assessing unreasonable fees, the reasonableness requirement contained in this grant assurance has no independent effect in this case.

part because one of its aeronautical costs is the "opportunity cost" it purportedly is incurring by using its airfield land for an airport rather than something else. DOT rejected that argument, finding among other things (1) that the City presently has no legal or practical opportunity to use the land for another purpose, and (2) that the enormous benefits bestowed on the City by LAX more than compensate for any purported lost opportunity costs.

The only relevance of the City's grant agreements in this case involved the effect of *unambiguous* provisions under which the City promised that "the airport will be available for public use," and that it "will not make or allow any alteration in the airport or any of its facilities if the alteration does not comply with the plan the Secretary approves, and the Secretary is of the opinion that the alteration may affect adversely the safety, utility, or efficiency of the airport." 49 U.S.C. § 47107(a)(1), (16)(C). *See also id.* § 47107(a)(8) ("a proposal to close the airport temporarily for a nonaeronautical purpose must first be approved by the Secretary"). There has never been a dispute in this case that "[t]hese provisions forbid the City from converting the airfield land to rental property." Pet. App. 6a.[8]

DOT simply referred to the *effect* of these unambiguous provisions as one of many reasons for rejecting the City's opportunity cost defense to the unreasonableness of its fees. As the grant assurances unambiguously provide, the City has no legal right to use its airfield land for any other purpose. It therefore follows logically that the City is presently incurring

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[8] In a footnote to its petition, the City makes the conclusory assertion that these provisions do not unambiguously impose a continuing duty to keep LAX in operation. City Pet. at 22 n.18. The City did not raise this argument at any point below, doubtless because the argument flatly contradicts the statutory language. Indeed, the City's own intervenor, ACI, notes that "Los Angeles agreed to operate LAX as an airport for a period of years (and thus to forego alternative uses of the land) . . . ." ACI Pet. at 18.

no compensable opportunity costs because the land is being devoted to its only permissible use. Or, as the Court of Appeals put it, "the City is like an owner of a hot dog stand who claims his opportunity cost is the revenue he would earn selling cocaine rather than hot dogs." Pet. App. 9a.[9]

Thus, this case does not involve any question about the interpretation of the City's grants, much less the proper standard of review applicable to such interpretations. As the Court of Appeals properly held, DOT's reasonableness determination did not add new conditions to, or misinterpret, the City's grants, but rather simply "focused on a *consequence* of an unambiguously imposed condition—that the airport would be kept open for public use—that was present from the outset." Pet. App. 13a (emphasis in original). There is no reason why DOT could not take into account the effect of an *unambiguous* grant provision—or any other legal

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[9] It should be noted that while the City and ACI belatedly—and wrongly—complain about the standard of review employed by the Court of Appeals, neither asks this Court to review the court's holding that DOT's reasonableness determination passed muster under the deferential standard mandated by *Chevron* and *Kent County*. That issue has long since been settled. This Court held long ago in *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), that an agency has the discretion to employ historic cost valuation in determining the reasonableness of rates. *See Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989) ("In *Hope* we ruled that historical cost was a valid basis on which to calculate utility compensation."). Under these precedents, DOT did not exceed its considerable discretion in rejecting the City's attempt to use purported "opportunity costs" to overturn the nearly universal agency preference for historic cost valuation that has prevailed since *Hope*. For even if the City may once have had an opportunity to use the LAX land for something else when the airport was constructed many decades ago, it clearly has none now. And the City's entirely *voluntary* decision to devote its land to airport use had nothing to do with the airlines which the City attempted to charge for these non-existent opportunity costs. It was therefore entirely reasonable for DOT to conclude that the City is not now incurring any ongoing, compensable opportunity costs by continuing to use LAX as an airport.

requirement—as one of many factors contributing to its informed policy judgment regarding the reasonableness of an airport rate. Indeed, even if DOT had ignored the effect of this grant assurance, it would have reached the same conclusion based on undisputed evidence that the City has no practical opportunity to relocate LAX. *See* Pet. App. 47a & n.13.

In sum, this Court has squarely held that DOT, like other agencies charged with determining the reasonableness of rates, has wide discretion in carrying out its delegated responsibility under the AHTA, and that the courts must accord its decisions substantial deference. Applying these well-settled standards, the Court of Appeals determined that DOT exercised its discretion in an appropriate manner. There is nothing about this typical rate case which remotely warrants this Court's intervention.

B. There is No Intracircuit Conflict

ACI (but not the City) urges the Court to resolve what it characterizes as an "intracircuit conflict" between the decision below and *LAX I*. *See* ACI Pet. at 13. There is no such conflict. The court in *LAX I* quite clearly held that "[h]istoric cost is, to be sure, one permissible measure of costs in cost-of-service ratemaking." Pet. App. 88a-89a. But because DOT had incorrectly determined, as a matter of law, that the governing statutes allowed airports to recover only their out-of-pocket costs, the panel remanded the case so that DOT could give "express consideration" to the City's opportunity cost argument. *Id.* at 93a. DOT followed those instructions faithfully, fully considering the issue for the first time on remand, and, in the decision below, the Court of Appeals upheld DOT's determination as a reasonable exercise of its policy judgment. *See also Policy Appeal*, 119 F.3d at 44.

In any event, as Justice Harlan once noted, "contrary decisions between different panels of the same Court of Appeals will not be considered to present a reviewable conflict, since

such differences of view are deemed an intramural matter to be resolved by the Court of Appeals itself." Hon. John M. Harlan, *Manning the Dikes*, 13 Record of N.Y.C. Bar Ass'n 541, 552 (1958).[10] The *en banc* process is the means of identifying and settling any intracircuit conflicts. Indeed, the absence of such a conflict in this case is demonstrated by the fact that no judge of the Court of Appeals—even the two who voted in favor of rehearing—identified such a conflict. Although those two judges believed the case should be remanded yet again for further consideration of the City's opportunity cost argument, neither of them in any way intimated that the decision below conflicted with *LAX I*. They did not do so because *LAX I* had simply remanded the case for consideration, as a matter of policy, of an argument that DOT had initially failed to consider.[11]

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[10] *See Davis v. United States*, 417 U.S. 333, 340 (1974) (noting denial of petition presenting intracircuit conflict); Robert L. Stern, *et al.*, *Supreme Court Practice* 176 (7th ed. 1993) ("Ordinarily, a conflict between decisions rendered by different panels of the same court of appeals is not a sufficient basis for granting a writ of certiorari.").

[11] ACI cites two cases in which the Court identified an intracircuit conflict in granting review, *see* ACI Pet. at 13 n.10, but both cases involved exceptional circumstances not presented here. In *Dickinson v. Petroleum Conversion Corp.*, 338 U.S. 507, 508 (1950), the Court reviewed a Second Circuit decision—rendered when *en banc* review was apparently unavailable in that court—adhering to the holding of an earlier decision with which the later panel unanimously disagreed. *See Lopinsky v. Hertz Drive-Ur-Self Sys., Inc.*, 194 F.2d 422, 429 (2d Cir. 1951) (Clark, J. concurring) (noting "the practice of this circuit never to sit in banc"). And in *Maggio v. Zeitz*, 333 U.S. 56 (1948), the Court reviewed another Second Circuit decision rendered during that same period, in light of that court's numerous conflicting decisions on the precise issue and its pre-eminent role in bankruptcy law at the time. *Id.* at 59-60. Here, by contrast, no judge of the Court of Appeals expressed disagreement with *LAX I*, and *en banc* review was available to resolve definitively any intra-circuit differences.

II. THIS CASE INVOLVES NO UNSETTLED ISSUE OF FEDERAL LAW

A. The Decision Below Does Not Conflict With This Court's Decision in *Kent County*

The City contends that the Court of Appeals' decision conflicts with this Court's holding in *Kent County* that the AHTA does not preclude an airport from establishing a "compensatory" methodology under which aeronautical users are charged for their share of airport costs without credit for surpluses that the airport may earn from unregulated non-aeronautical users such as concessionaires. *See* City Pet. at 25-29; *cf.* ACI Pet. at 19 (describing *Kent County* as addressing "similar" issue). This contention is baseless.

As the Court of Appeals correctly held, DOT "in no sense adopted a requirement that airports must credit their non-airfield surpluses toward their airfield costs." Pet. App. 14a. Quite to the contrary, DOT clearly held that the Airlines were required to pay for their share of *all* legitimate airport costs. *See* Pet. App. 51a ("we are not using the City's benefits to offset the City's other airfield costs"). As the Court of Appeals noted, DOT merely referred to non-aeronautical surpluses, as well as the enormous economic benefit LAX bestows on the City, as additional reasons for rejecting the City's contention that one of its "costs" is the purported opportunity cost it presently incurs by not using its airfield land for something other than an airport. *See* Pet. App. 14a ("The DOT is only taking into account non-airfield revenues, as well as all other economic benefits the City enjoys, in determining whether Los Angeles really has an uncovered opportunity cost."); *see also id.* at 51a-52.

The City has defended its fees with the contention that it is incurring enormous *costs*—which the Airlines must pay for—because it is not devoting its airfield land to some other use. Nothing in *Kent County* prevented DOT, in evaluating that argument, from considering evidence that the City is in

fact reaping enormous *benefits* from using its land in that manner. As the Court of Appeals put it,

> [i]t is the City itself, by using the opportunity costs concept, that has invited the Department to think broadly about how such costs should be measured. And we cannot hold that it was unreasonable for the DOT, when faced with a demand for economic analysis, to consider factors that an economist might take into account.

Pet. App. 14a-15a.

Contrary to ACI's preposterous suggestion, *see* ACI Pet. at 18, 20, such an analysis did not in this case—and could not ever—lead to airlines being charged nothing for their use of an airport. Airlines will continue to pay their share of all legitimate airport costs; DOT simply determined in this case that it was unreasonable for the City to charge the Airlines for non-existent "opportunity costs," thereby adding to its mounting surpluses available for unlawful diversion.

B. ACI's Tenth Amendment Argument Has Been Waived and is Frivolous

In its petition, ACI raises—for the first time in this five-year-long litigation—the contention that the decision below violates the Tenth Amendment and principles of "comity and federalism." *See* ACI Pet. at 21-23. The issue—which the City properly does not raise—was neither raised below nor considered by DOT or the Court of Appeals. The question is therefore not properly before the Court. *See* cases cited *supra* note 6.

But in any event, the issue is frivolous. The AHTA in no way " 'commandeers the legislative processes of the States by directly compelling them to enact and enforce a federal regulatory program.' " *New York v. United States*, 505 U.S. 144, 176 (1992) (citation omitted). Like other similar regulatory statutes enacted pursuant to Congress' Commerce Clause power, the AHTA prohibits airports from imposing

unreasonable fees on aeronautical users. The AHTA was prompted by Congress' concern that permitting airports (all of which happen to be owned by state and local governments) to assess unreasonable fees would result in "a proliferation of local taxes burdensome to interstate air transportation." *Kent County*, 510 U.S. at 363 (discussing legislative history). The AHTA alleviates this burden on interstate commerce by pre-empting unreasonable fees imposed by state and local governments in their capacities as airport operators. Nothing about the AHTA or its implementation by DOT even remotely raises a concern about "commandeering" state legislative processes to enact or enforce a federal regulatory program.

III. THIS CASE INVOLVES NO RECURRING ISSUE OF NATIONAL IMPORTANCE

The record in this case is clear that of the more than 500 public commercial service airports in the Nation, only *one*—LAX—has *ever* attempted to set landing fees based on the purported fair market value of airfield land. Every other airport employing a compensatory methodology has based its fees instead on the historic cost of that land—a methodology approved by this Court in *Hope Natural Gas* and almost universally employed by regulatory agencies. *See, e.g.*, 18 C.F.R. Part 201 at 507 (definition 9), 522 (instruction 7) (1999) (FERC requirement that land comprising gas plants be valued at historic cost); Charles F. Phillips, Jr., *The Regulation of Public Utilities: Theory and Practice* 350 (1993) (utility commissions generally value land at historic cost); *see also supra* note 9.

Indeed, the expert who devised the City's own fees stated at the time that "fair market" valuation had never been used before at U.S. airports to set landing fees, and LAX therefore "would be the first U.S. airport to do so." J.A. 222. *See also* J.A. 169-170 (hearing testimony). Thus, DOT expressly recognized the "undisputed fact that no other U.S. airport

calculates its landing fees on the basis of the fair market value of its airfield land, as shown by the record." Pet. App. 56a-57a. *See also* J.A. 506 (finding in initial decision that "historic cost has been the measure universally used by airports for valuing airfield land"). Even after the City imposed its new fees, no other airport followed suit.

This case therefore involves an isolated, unrepeated dispute between a single airport and the airlines serving it. That dispute was fostered by the City's attempt to generate enormous surpluses—over and above the actual capital and operating costs of LAX—available for possible diversion to pay general City expenses. Without the City's express policy of seeking to divert revenues whenever possible, there would have been little incentive for it to impose land rental charges whose only purpose is to generate such surpluses. *See* J.A. 189 (statement of City's expert that "[t]he use of airport revenues and the establishment of landing fees are interrelated"). No other airport operator has been as brazen in its desire to divert revenues, and none has sought to impose these charges. Moreover, DOT is presently considering, but has not yet promulgated, rules addressing this and related issues on a nationwide basis. *See* Pet. App. 8a; 63 Fed. Reg. 43,228 (1998). Thus, even if this case presented an important, unsettled issue of federal law—and it does not—there would be no cause for the Court to devote its scarce resources to resolving this unique dispute.

CONCLUSION

For the foregoing reasons, the petitions should be denied.

Respectfully submitted,

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Nos. 99-466 and 99-500

In the Supreme Court of the United States

CITY OF LOS ANGELES, ET AL., PETITIONERS

v.

DEPARTMENT OF TRANSPORTATION, ET AL.

AIRPORTS COUNCIL INTERNATIONAL–NORTH AMERICA, PETITIONER

v.

DEPARTMENT OF TRANSPORTATION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

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15??

QUESTION PRESENTED

Whether the Department of Transportation permissibly determined under 49 U.S.C. 47129(a)(1) (1994 & Supp. III 1997) that it was unreasonable for the City of Los Angeles to calculate airport landing fees at Los Angeles International Airport based on the fair market rental value of the airfield land.

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In the Supreme Court of the United States

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BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-17a) is reported 165 F.3d 972. The per curiam order of the court of appeals denying rehearing (Pet. App. 109a-117a) is reported at 179 F.3d 937. The decision of the

Department of Transportation (Pet. App. 18a-78a) is unreported.[1]

JURISDICTION

The judgment of the court of appeals was entered on February 5, 1999. The petitions for rehearing were denied on June 18, 1999 (Pet. App. 118a). The petitions for a writ of certiorari were filed on September 16, 1999. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Anti-Head Tax Act permits state and local governments to collect "reasonable rental charges, landing fees, and other service charges from aircraft operators for using airport facilities of an airport owned or operated by that State or subdivision." 49 U.S.C. 40116(e)(2). A second statute, 49 U.S.C. 47107, requires airports that accept federal grants to comply with certain conditions, including that "the airport will be available for public use on reasonable conditions and without unjust discrimination." 49 U.S.C. 47107(a)(1). The Federal Aviation Administration Authorization Act of 1994 (FAAAA), Pub. L. No. 103-305, 108 Stat. 1569, requires the Secretary of Transportation to "issue a determination as to whether a fee imposed upon one or more air carriers * * * by the owner or operator of an airport is reasonable," if either an air carrier or the owner or operator of an airport requests such a determination. 49 U.S.C. 47129(a)(1) (1994 & Supp. III 1997). Under the FAAAA, the Secretary "may only determine whether the fee is reasonable or unreasonable and shall not set the level of the fee." 49 U.S.C. 47129(a)(3).

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[1] References to Pet. App. refer to the appendix included in the petition filed by the City of Los Angeles et al., No. 99-466.

The FAAAA also provides that "[a] fee subject to a determination of reasonableness * * * may be calculated pursuant to either a compensatory or residual fee methodology or any combination thereof." 49 U.S.C. 47129(a)(2). Under a residual methodology, the airport's profits from non-airfield sources—such as parking contracts and concession franchising—are used to reduce the airlines' landing fees. By contrast, a compensatory methodology calculates landing fees at a level sufficient to recover the entirety of the airport's aeronautical cost, without regard to revenues generated from non-aeronautical sources. Pet. App. 2a-3a, 14a n.3, 24a-25a.

2. Petitioners City of Los Angeles, the City of Los Angeles Department of Airports, and the Los Angeles Board of Airport Commissioners (collectively the City) own and operate Los Angeles International Airport (LAX). Petitioner Airports Council International–North America (ACI-NA) is an airport trade association.

Before 1993, the City, pursuant to contracts with the airlines using LAX, calculated landing fees based on a residual methodology that applied any expected non-aeronautical surplus to the anticipated costs of aeronautical operations. Pet. App. 2a-3a. In 1993, the City proposed to calculate landing fees using a compensatory methodology that would charge the airlines for the entirety of its aeronautical costs. Also for the first time, the City included in its estimated aeronautical cost the current annual fair market rental value of the airfield land, on the theory that such valuation was necessary to compensate the City for the ongoing "opportunity cost" of using the airfield land for airport purposes. Appraising the airfield land at fair market value, together with other costs, led the City to propose

trebling the airlines' landing fees. When contract negotiations with the airlines for a compensatory fee agreement failed, the City unilaterally imposed the increased fees. *Id.* at 3a-4a.

The airlines filed a complaint with the Secretary under the FAAAA, challenging the new fees, including the fair market rental value charge. The Secretary concluded that the City's fair market value charge was unreasonable, because the Anti-Head Tax Act required that the City value the airfield land according to its historic cost. Pet. App. 4a-5a. The court of appeals reversed, holding that the Secretary erroneously concluded that the Anti-Head Tax Act mandated the use of historic cost valuation to the exclusion of every other method of valuing the land under the airfield. *Id.* at 5a (citing *City of Los Angeles* v. *DOT* (*LAX I*), 103 F.3d 1027, 1032 (D.C. Cir 1997)). The court of appeals in *LAX I* accordingly directed the Secretary on remand to consider the "respective merits of the historic cost and fair market value methodologies here at issue." 103 F.3d at 1032; see also Pet. App. at 87a-94a.

3. On remand, the Secretary concluded that the City unreasonably calculated landing fees at LAX based on the fair market rental value of the airfield land. Pet. App. 18a-78a. The Secretary rejected the City's principal contention that the fair market value calculation was needed to defray the City's opportunity costs of using the airfield land for airport purposes. The Secretary reasoned that the City "incurs no opportunity cost when the airfield land is used for the airfield," because the City is legally obligated to continue using LAX as an airport. *Id.* at 38a. The Secretary explained that the City accepted federal grants for the eleven years preceding 1993 under agreements in which the City assured the FAA that it would continue operating LAX

as an airport for the foreseeable future. *Id.* at 40a-41a. The Secretary also reasoned that the City was bound by federal law to make LAX available for public use as an airport and not to alter LAX's layout plan without the Secretary's prior approval. *Id.* at 40a (citing 49 U.S.C. 47107(a)(1) and (16)).

The Secretary also rejected the City's contention that a fair market value charge was necessary "to give the City 'the proper incentive' to continue operating the airport." Pet. App. 45a. The Secretary concluded that "the City has not shown that it needs any such incentive," because "[t]he airport provides major benefits for the Los Angeles area's economy, generates large earnings, and cannot practicably be replaced or moved." *Ibid.* The Secretary explained that

> [t]he City's calculation of its alleged opportunity costs gave no recognition to the benefits it receives from the airport. The City's position essentially assumes that the City's use of the land as an airport creates no benefits at all for the City, a statement which * * * is contrary to the record and common sense.

Pet. App. 50a.

The Secretary also relied on the fact that "no other U.S. airport calculates its landing fees on the basis of the fair market value of its airfield land." Pet. App. 56a-57a. The Secretary reasoned that the universal practice by airports of valuing airfield land at historic cost in setting compensatory fees "suggests that the [fair market value] charge is neither essential for airport operations nor generally viewed by other airports as desirable." *Id.* at 57a.

4. The court of appeals affirmed. Pet. App. 1a-17a. The court of appeals held that the Secretary reasonably

rejected the City's fair market value charge on the ground that the City had a fixed legal obligation to use LAX as an airport. *Id.* at 10a-12a. The court of appeals also upheld as reasonable the Secretary's alternative conclusion that the benefits that LAX confers on the City offset any opportunity costs resulting from operating LAX as an airport. Pet. App. 13a-15a.[2]

The court of appeals denied rehearing en banc. Pet. App. 109a-110a. Judge Silberman filed a statement concurring in the denial of rehearing en banc. *Id.* at 110a-113a. Judge Williams and Judge Ginsburg dissented. *Id.* at 113a-117a. In their view, the agency had not set forth an adequate basis for rejecting the City's contention that it reasonably set landing fees based on its opportunity costs. *Ibid.*

ARGUMENT

1. Petitioner ACI-NA contends (Pet. 13-14) that this Court should grant certiorari to resolve an alleged inconsistency between the court of appeals' decision and its prior decision in *LAX I*. The decision below, however, does not conflict with *LAX I*. In *LAX I*, the court of appeals held that the Secretary had misconstrued the Anti-Head Tax Act and 49 U.S.C. 47129 (1994 & Supp. III 1997) to mandate that landing fees be assessed based on the historic cost of the airfield. Pet. App. 88a-90a. The court of appeals thus directed the Secretary on remand to "give express consideration to the City's arguments in support of market valuation, which he did not address before presumably because he thought he was bound by the statute to use the historic

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[2] The court of appeals also rejected the City's contention that the Secretary's decision constituted an unconstitutional taking. Pet. App. 15a-17a. Petitioners do not ask this Court to review that ruling.

cost approach." *Id.* at 93a. Nothing in that decision barred the Secretary on remand from considering the City's claim of opportunity costs, and then determining that the City's opportunity costs were nonexistent because the City was bound by its grant obligations to operate LAX as an airport. Because the court of appeals in *LAX I* "did not analyze any argument based upon the federal airport grant provision," *Id.* at 12a-13a, *LAX I* is entirely consistent with the court of appeals' conclusion that the Secretary reasonably considered and rejected the City's opportunity cost theory.[3]

2. Petitioners contend (City Pet. 18-24; ACI-NA Pet. 14-17) that the court of appeals erred in deferring to the Secretary's determination because the federal airport grants to the City did not unambiguously state that the City could not use fair market valuation in setting landing fees at LAX. Petitioners argue that the decision below was therefore at odds with *Pennhurst State School & Hospital* v. *Halderman*, 451 U.S. 1, 17 (1981), in which this Court stated that "if Congress intends to impose a condition on the grant of federal moneys, it must do so unambiguously."

Nothing in the decision in *Pennhurst* suggests, however, that when it is clear that Congress intends to impose obligations on local governments receiving federal funds, the scope of those obligations should be determined by anything other than normal rules of statutory construction, including principles of deference

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[3] In any event, any inconsistency between the two decisions of the D.C. Circuit would not warrant resolution by this Court. *Wisniewski* v. *United States*, 353 U.S. 901, 902 (1957) (per curiam) ("It is primarily the task of a Court of Appeals to reconcile its internal difficulties.").

set forth in *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). Here, Congress has expressly provided that the Secretary "shall issue a determination as to whether a fee imposed upon one or more air carriers * * * by the owner or operator of an airport is reasonable." 49 U.S.C. 47129(a)(1) (1994 & Supp III 1997). The Secretary's reasonable determination under that delegated power is therefore entitled to deference.

Indeed, even before Congress passed the FAAAA to direct the Secretary to resolve airport fees disputes, this Court recognized that the Secretary is "equipped, as courts are not, to survey the field nationwide, and to regulate" airport fees imposed under the Anti-Head Tax Act. *Northwest Airlines, Inc.* v. *County of Kent*, 510 U.S. 355, 367 (1994). The Court likewise concluded that the Secretary's reasoned decision on the appropriateness of a fee methodology would be entitled to "substantial deference." *Ibid.* (citing *Chevron U.S.A.* 467 U.S. at 842-845); see also *Kent*, 510 U.S. at 368 n.14 (noting that the Secretary could use his "capacity to comprehend the details of airport operations across the country and the economics of the air transportation industry" in order to determine whether fees are reasonable under Anti-Head Tax Act, and that Secretary's "exposition will merit judicial approbation" if it is based on permissible reading of the statute). The court of appeals thus properly deferred to the Secretary's reasoned determination under the FAAAA.[4] Cf. *City*

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[4] For those reasons, petitioners err in contending (City Pet. 17-21; ACI-NA Pet. 15) that the court of appeals' decision conflicts with *Virginia Department of Education* v. *Riley*, 106 F.3d 559 (4th Cir. 1997) (en banc), and *Doe* v. *Oak Park & River Forest High School District*, 115 F.3d 1273 (7th Cir.), cert. denied, 118 S. Ct. 564 (1997). Those decisions, which petitioners did not cite before the

of New York v. *FCC*, 486 U.S. 57, 64 (1988) (statutorily authorized regulations of federal agency pre-empt conflicting state or local law).

Moreover, the Secretary's conclusion that the City has no recoverable opportunity costs in operating the airfield land for airport purposes did not add any new condition to the federal grant. Federal law and the grant agreements with the City clearly require the City to use LAX for airport purposes and to impose only reasonable fees. Pet. App. 12a, 39a-42a.[5] Because those obligations bar the City from converting the airport to other uses, the Secretary determined that the City unreasonably employed a fair market value methodology to compensate it for the opportunity cost of putting the airport to other uses. As the court of appeals explained, the Secretary's ruling simply "focused on a *consequence* of an unambiguously imposed condition—that the airport would be kept open for public use—that was present from the outset." *Id.* at 13a. The Secretary therefore properly relied on the City's grant assurances in determining that the City's proposed opportunity cost pricing was unreasonable.[6]

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court of appeals, address the obligations of state and local governments under the Individuals with Disabilities Education Act, 20 U.S.C. 1412(1), to "assure[] all children with disabilities the right to a free appropriate public education."

[5] The City implies (Pet. 22 n.18) that the grant conditions do not expressly require it to operate LAX as an airport. The City did not challenge, however, the Secretary's conclusion that the City must use the airfield for airport purposes, Pet. App. 39a-42a, and petitioners do not suggest that the City presently may convert the airport to any other use.

[6] Indeed, it is difficult to imagine how, under the petitioners' theory, the Secretary could fulfill his statutory mandate under 49 U.S.C. 47129 (1994 & Supp. III 1997) to determine whether airport

3. Petitioners also argue (City Pet. 25-29; ACI-NA Pet. 16-20) that the Secretary's alternative rationale—that any opportunity costs incurred by the City are offset by the benefits the City receives from LAX—conflicts with 49 U.S.C. 47129(a)(2), which permits airlines to adopt a compensatory fee methodology, and is inconsistent with the Court's acceptance of a compensatory methodology in *Kent*. Neither of those contentions has merit.

As an initial matter, the Secretary's decision does not bar the City from charging compensatory fees that reimburse the City for the entirety of its aeronautical operations cost, without regard to any surplus or deficit in revenues from non-aeronautical operations. Rather, the Secretary concluded that it was unreasonable for the City to calculate its aeronautical costs by using the fair market value of the airfield land when the City incurs no opportunity costs from using the airfield land for airport purposes. As the Secretary stated, his "analysis in no way precludes the airport from charging landing fees covering its other costs. Indeed, [the Secretary] ha[s] upheld over the airline complainants' objections most of the other charges included in calculating the LAX landing fees." Pet. App. 52a.

The Secretary's reasoning is also fully consistent with this Court's decision in *Kent*. In that case, the Court held that the reasonable fee requirement of the Anti-Head Tax Act does not compel an airport to use its earnings from non-aeronautical sources to lower its aeronautical fees, and that an airport may reasonably

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fees are reasonable. The statutory scheme would become a virtual nullity if the basis for a determination by the Secretary that a fee is unreasonable could be challenged as an impermissible "new condition" on the local government.

charge airlines for the full cost of providing the particular facilities and services they use. 510 U.S. at 369-372. The Court did not address whether an airport operator may calculate its aeronautical costs by the fair market rental value of airfield land based on opportunity costs. Indeed, LAX is the only airport in the country that has attempted to base its landing fees on its airfield's fair market value. Pet. App. 56a-57a.

Moreover, the Secretary's decision "in no sense adopted a general requirement that airports must credit their non-airfield surpluses toward their airfield costs." Pet. App. 14a; see also *id.* at 51a ("we are not using the City's benefits to offset the City's other airfield costs"). Rather, the City's contentions that it incurred opportunity costs invited the Secretary to consider whether the benefits to the City from the airport were insufficient to give the City an incentive to continue to operate LAX. *Id.* at 14a; see also *id.* at 50a-51a ("The City's expert * * * stated that a person's use of a property incurs no opportunity costs if that use generates more revenue than the person could obtain from any other use of the property."). The court of appeals therefore correctly concluded that it was reasonable for the Secretary, "when faced with a demand for an economic analysis, to consider factors that an economist might take into account." *Id.* at 14a-15a; see also *Kent*, 510 U.S. at 367, 368 n.14.

4. Petitioner ACI-NA also asserts (Pet. 21-23) that the Secretary's determination requires the City to subsidize airlines in violation of the Tenth Amendment principles articulated in *New York* v. *United States*, 505 U.S. 144 (1992), and *Printz* v. *United States*, 521 U.S. 898 (1997). That argument was not made below and, accordingly, is not properly before this Court. See, *e.g.*, *Youakim* v. *Miller*, 425 U.S. 231, 234 (1976) (per cu-

riam) ("Ordinarily, this Court does not decide questions not raised or resolved in the lower court."); accord *Auer* v. *Robbins*, 519 U.S. 452, 463-464 (1997); *Citizens Bank of Md.* v. *Strumpf*, 516 U.S. 16, 20 n.* (1995); *Delta Air Lines, Inc.* v. *August*, 450 U.S. 346, 362 (1981).

In any event, petitioner's contention erroneously assumes that the City must subsidize airlines because the City cannot recover the opportunity costs of continuing to operate LAX as an airport. As discussed above, however, the City is prohibited from converting LAX to non-airport uses and therefore incurs no such opportunity costs. The Secretary therefore properly determined that it was unreasonable for the City to take the unprecedented step of charging airlines the fair market rental value of airfield land based on a "non-existent opportunity" to use the land for non-airport purposes. Pet. App. 111a (Silberman, J., concurring in the denial of rehearing en banc).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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Pennhurst State Sch. & Hosp. v. Halderman, 451 U.S. 1 (1981) ..... *passim*

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STATUTES AND REGULATIONS

49 U.S.C. § 47129(a)(2) 6, 7

49 U.S.C. app. § 1513 (recodified at 49 U.S.C. § 40116) (Anti-Head Tax Act) 3

Airport and Airway Improvement Act of 1982, Pub. L. No. 97-248, 96 Stat. 671, 49 U.S.C. § 47101 *et seq.* (formerly codified at 49 U.S.C. app. § 2210 *et seq.*) 3

REPLY BRIEF OF THE PETITIONERS

1. Commendably, the Government's Brief in Opposition ("Govt. Opp.") does not contest that this case properly presents for review the question whether the decision below is at odds with the requirement of *Pennhurst State School & Hospital v. Halderman*, 451 U.S. 1, 17 (1981), that "if Congress intends to impose a condition on the grant of federal moneys, it must do so unambiguously." The Government also does not dispute that this case properly presents the question whether the proper standard of judicial review of an agency's interpretation of a grant condition is one derived from *Pennhurst* or one derived from *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). The Government could hardly take a different position since the court of appeals' opinion in *LAX II* expressly addressed both the issue of whether DOT's reliance on two grant assurances to deprive the City of the ability to recover the fair market value ("FMV") of airfield land "conflicts with the 'clear statement' requirement of *Pennhurst*," Pet. App. at 13a, and whether the court was "obliged to defer to a reasonable judgment by an agency acting pursuant to congressionally delegated authority," Pet. App. at 11a; *see also* Pet. App. at 110a-111a (Silberman, J., concurring in denial of rehearing *en banc*).[1]

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[1] By contrast, respondent Air Transport Association of America ("ATA") has chosen not to be as forthright with the Court.

First, ATA asserts that "even if this case involved a question regarding the proper standard for reviewing agency interpretation of grant agreements . . . the issue has been waived." ATA Opp. at 13. That assertion is demonstrably false, as the opinions in the court of appeals make clear.

Instead, the Government states that "[n]othing in the decision in *Pennhurst* suggests . . . that when it is clear that Congress intends to impose obligations on local governments receiving federal funds, the scope of those obligations should be determined by anything other than normal rules of statutory construction, including principles of deference set forth in *Chevron*. . . ." Govt. Opp. at 7-8. The Government's arguments, however, are either immaterial, squarely contrary to the holding in *Pennhurst* and its progeny, or contrary to the decision and supporting record that the Government wishes to uphold.

Second, in an attempt to paint the City as two-faced, ATA distorts the City's position in *Northwest Airlines, Inc. v. County of Kent*, 510 U.S. 355 (1994) ("*Kent County*"). Contrary to ATA's assertion, ATA Opp. at 10-12, the City has not changed its position on whether deference should be given to DOT. The question of what deference the courts should give to an interpretation by DOT of grant conditions imposed by the AAIA was not presented in *Kent County*, and accordingly the City took no position on that issue then. *See Kent County*, 510 U.S. at 361, 372 (petitioners did not seek review of the Sixth Circuit holding that the AAIA does not confer a private right of action on air carriers; thus, questions concerning the AAIA were not properly before the Court).

The City believes it is unwise (and unnecessary) to use its limited space in this paper to respond to most of the other arguments raised solely by ATA, especially ATA's allegations concerning revenue diversion. *See* ATA Opp. at 3-5, 19, 21. The irrelevance of these allegations is demonstrated by the fact that, although ATA has continuously trotted out this argument, neither DOT nor the court of appeals has ever accepted it in any of the proceedings below.

The Government's contention that *Chevron* deference to DOT's resolution of airport fee disputes was commanded by this Court's decision in *Kent County* is misplaced. *Kent County* was a case brought by air carriers in district court under the Anti-Head Tax Act ("AHTA"), 49 U.S.C. app. § 1513 (recodified at 49 U.S.C. § 40116). Airport Improvement Project ("AIP") grant assurances required by the Airport and Airways Improvement Act ("AAIA"), 49 U.S.C. § 47101 *et seq.* (formerly codified at 49 U.S.C. app. § 2201 *et seq.*), were not at issue in the case. *See* 510 U.S. at 361, 372. Statutory AIP grant assurances were not used, as they were in this case, as the basis for a DOT determination as to the reasonableness of an airport's rates. Thus, this Court had no occasion to consider the interplay between the federalism concerns underlying the "clear statement" requirement of *Pennhurst* and the "normal rules of statutory construction," including *Chevron* deference.

The Government never justifies its assertion that "petitioners err in contending . . . that the court of appeals' decision conflicts with *Virginia Department of Education v. Riley*, 106 F.3d 559 (4th Cir. 1997) (*en banc*), and *Doe v. Oak Park & River Forest High School District*, 115 F.3d 1273 (7th Cir.), *cert. denied*, 118 S. Ct. 564 (1997)." Govt. Opp. at 8 n.4. Indeed, the Government appears to argue that these cases are different because they "address the obligations of state and local governments under the Individuals with Disabilities Education Act," while the present case involves a "determination under the [Federal Aviation Administration Authorization Act of 1994]." *Id.* at 8, 9 n.4. *Pennhurst*, however, is not limited to cases

arising in connection with education grants.[2] As the Fourth Circuit in *Riley* and the Seventh Circuit in *Oak Park* recognized, the principle at stake in these cases is "the permissible reach of federal power under the Spending Clause." *Virginia Dep't of Educ. v. Riley*, 106 F.3d 559, 570 (4th Cir. 1997) (*en banc*); *see also Doe v. Oak Park & River Forest High Sch. Dist.*, 115 F.3d 1273, 1278 (7th Cir.) (adopting reasoning in *Riley*), *cert. denied*, 118 S. Ct. 546 (1997). More specifically, the question is whether, after accepting federal funds, states and localities can be bound by later agency-created conditions of which they had no clear notice. That principle is as applicable to the AIP grants involved in this case as it was to the education grants involved in *Riley* and *Oak Park*.

The Government places primary reliance on the contention, derived from the *LAX II* opinion, that DOT's decision that the City has no opportunity costs in its airfield land was merely "*a consequence* of an unambiguously imposed condition – that the airport would be kept open for public use," Pet. App. at 13a (emphasis in original), and, thus, did not add any new condition to the federal grant. This contention, however, essentially concedes that the City was *not* unambiguously informed at

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[2] *See, e.g., Suter v. Artist M.*, 503 U.S. 347, 356 (1992) (applying *Pennhurst*, held States receiving funds under Adoption and Assistance Act of 1980 were not given unambiguous notice that the Act could be enforced by private individuals or that the Act created a private right of action); *South Dakota v. Dole*, 483 U.S. 203, 207-208 (1987) (upholding as consistent with *Pennhurst* a clearly stated condition withholding a portion of a State's federal highway funds if it did not adopt a 21-year-old drinking age).

the time it took AIP grants that they prohibited the use of FMV to value airfield land. If an agency or reviewing court is permitted to rely upon unstated, alleged "consequences" of grant conditions – rather than their plain language – the "clear statement" requirement of *Pennhurst* would be rendered a dead letter. It would be the rare instance that an agency would not be able to tease from one grant condition or another a "consequence" that would be capable of imposing a new, unanticipated restriction on federal grant recipients not specifically set forth in the grant conditions themselves.

This conclusion is well-illustrated by the record in this case. Although the *LAX II* opinion states that DOT's prohibition on use of FMV to value airfield land was a consequence of grant conditions, DOT had not conjured up that "consequence" prior to its December 23, 1997 Remand Decision, even though administrative proceedings had been ongoing since October 21, 1994. Pet. App. at 84a. During that three-year period, the air carriers filed a complaint and an amended complaint, there were two full adjudicatory hearings, two ALJ recommended decisions, two final DOT decisions, thousands of pages of testimony and briefing by the parties and two court of appeals opinions – *LAX I* and the *Policy Appeal*. At no time during that entire period did DOT ever state that LAX could not use FMV to value airfield land as a "consequence" of its grant conditions. This supposed consequence of the City's grant assurances was only invented by DOT after its initial decision was set aside in *LAX I*. This is surely a harbinger of what administrative agencies will be inclined to do in the future if they are permitted to swap "consequences" as sanctioned by *LAX II* for the

"clear and unambiguous" grant conditions required by *Pennhurst*.

2. The essence of the decision in *Kent County* is that in setting reasonable compensatory rates and charges, airport owners are not required, as the air carriers had urged, to recognize the "interdependency" of aeronautical and non-aeronautical activities, and thus are not required to offset aeronautical costs with non-aeronautical benefits. *Northwest Airlines, Inc. v. County of Kent, Mich.*, 738 F. Supp. 1112, 1114 (W.D. Mich. 1990), *aff'd in part, rev'd in part*, 955 F.2d 1054, 1057 (6th Cir. 1992), *aff'd*, 510 U.S. 355 (1994). Instead, the reasonableness of compensatory aeronautical rates is to be determined without considering the costs or benefits of non-aeronautical activities. This approach was later expressly endorsed by Congress in 49 U.S.C. § 47129(a)(2) (specifically authorizing compensatory rate-setting) after the air carriers sought unsuccessfully to reverse *Kent County* through legislation.

DOT and the court of appeals in *LAX II* nevertheless held that, even if the City's grant assurances did not bar the City from recovering the opportunity costs of devoting its land to airfield use, it would be unreasonable to allow opportunity cost recovery because of the non-aeronautical benefits generated by the airport. Pet. App. 13a-15a. In *Kent County*, however, this Court rejected the air carriers' claim that such non-aeronautical benefits should be taken into account in determining the reasonableness of aeronautical charges. *See* 510 U.S at 369-70. The flaw in the logic of the reasoning of DOT and the court of appeals can easily be revealed. If in the future LAX begins to lose money or to cause environmental

harm to the community, the air carriers and DOT would surely resist any effort by the City to increase its landing fees to compensate for those loses or for off-airport impacts. They would no doubt claim that the City bore those risks when it chose to use compensatory rates and could not reasonably include non-airfield losses in its landing fee because to do so would violate the principle of independence that defines the compensatory method approved by this Court in *Kent County* and codified by Congress in 49 U.S.C. § 47129(a)(2). The same principle, however, bars DOT from relying on non-airfield revenues or benefits to justify its decision prohibiting the City from recovering the FMV of airfield land in its landing fees today.

3. If the court of appeals' decision is permitted to stand, the federal government's power to regulate state and local governments pursuant to Congress's Spending Clause would be expanded dramatically by permitting administrative agencies to infuse grant conditions with unanticipated "consequences" by relying on *Chevron* and disregarding *Pennhurst*. Perhaps for this reason, the Government does not question the national importance of the issues presented by the petitions for certiorari. ATA, on the other hand, inexplicably belittles this as a case involving "an isolated, unrepeated dispute between a single airport and the airlines serving it." ATA Opp. at 21.[3]

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[3] For purposes of its opposition, ATA falsely portrays this question as unlikely to arise anywhere but in Los Angeles. ATA Opp. at 20-21. In fact, this precise issue is likely to arise at many airports throughout the Nation in the future. Like many airport owners, at the advent of the jet age the City entered into long-term "residual" rate-setting agreements with the air carriers.

However, when the very same air carriers (represented by the very same lawyers) successfully sought a writ of certiorari in *Kent County*, they took the exact opposite position. In *Kent County*, they argued that this Court should grant certiorari because of the national importance of the economic relationships between local airport owners and commercial air carriers and because of the significance of the rules that would be established for all airports by the resolution of a single dispute involving a small, regional airport in Grand Rapids, Michigan. They stressed that the Court's decision would "necessarily affect 'airports across the country.'" Petition for Certiorari in No. 92-97 at 20 (quoting *Northwest Airlines, Inc. v. County of Kent, Mich.*, 955 F.2d 1054, 1066 (6th Cir. 1992) (Merritt, C.J., dissenting from denial of rehearing *en banc*).[4]

After these agreements expired in 1992, the City exercised its legal right to switch to a compensatory rate-setting methodology. Similar agreements have begun to expire at many other airports as well. As they do, airport operators will be able to employ compensatory rate-setting methods – and will be free to seek to impose FMV charges for a wide variety of facilities that the air carriers are currently using at far less than their economic cost. Thus, whether it is reasonable for airports to use FMV to value facilities is of critical importance for the Nation's airport owners and operators. It is for this reason that the national association of commercial airport owners and operators, Airports Council International-North America, has filed its own petition for certiorari in order to protect the rights of its members.

[4] In their petition for a writ of certiorari in *Kent County*, the airlines took pains to underscore the likelihood that the Court's decision would affect "numerous other airports" and noted that at the time this Court granted certiorari in *Evansville-Vanderburgh Airport Authority District v. Delta Airlines, Inc.*, 405 U.S. 707 (1972), "only five or six jurisdictions" were imposing

Stronger considerations than those advanced by the air carriers in *Kent County* warrant certiorari in this case.

CONCLUSION

For all of the foregoing reasons, and the reasons stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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airport "head taxes," but in the year following the Court's decision in *Evansville*, "44 jurisdictions had adopted the tax." Petition for Certiorari in No. 92-97 at 20-21 & n.13.

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